STATE OF CALIFORNIA
DEPARTMENT OF INSURANCE
45 Fremont Street
San Francisco, CA 94105

RH05049799 **January 5, 2006**

TITLE 10. INVESTMENTS
CHAPTER 5. INSURANCE COMMISSIONER
Article 7.1
TITLE INSURANCE STATISTICAL PLAN
AND RELATED RULES GOVERNING RATES AND CHARGES

Summary and Response to Comments Received During
Revised Regulation Comment Period

VOLUME 10

Volume 10, Comment No. "Dec.comments 352-355":

Commentator: Bedulah Stidham, Madrona Park Escrow, Inc.
Date of Comment: Received 12/7/06
Type of Comment: Written

Summary of Comment: The commenter attaches an article, concerning the efforts to combat illegal rebating and illegal title and escrow charges by the Missouri Consumer Affairs Division of the Department of Insurance. The commenter suggests that the Commissioner should follow Missouri's approach rather than the approach embodied in the proposed regulations.

Response to Comment:

The Commissioner rejects this comment. The Missouri article supports, rather than detracts from the Commissioner's proposed regulations. Indeed, as the article reflects, the Missouri Department's director concluded that its investigation of 31 title insurers' and their alleged illegal rebating activities produced findings which were described as "discouraging" and required new action "to ensure Missouri consumers are treated fairly and honestly." Indeed, the fact that the Missouri Department uncovered numerous allegedly illegal rebating activities and overcharging of consumers led the Director to express hope that "the [Legislature] will pass a bill to address the lack of oversight over escrow funds," suggesting that the Missouri Department would favor rate regulation over the current system of assessing penalties for rebating activities.

The California Insurance Commissioner has concluded that enforcement, without appropriate rate regulation, is not sufficient to stem the tide of illegal rebating activities.

The attached article merely confirms that the Commissioner's approach as proposed in the regulations is necessary.

Volume 10, Comment No. "Dec.comments 356-512":

Commentator: Robert Hogeboom on behalf of LandAmerica Title Insurance Group
Date of Comment: Received 12/15/06
Type of Comment: Written

Summary of Comment (page 1-2):

This passage summarizes the commenter's affiliation and identifies the comments that are set forth in greater detail within the body of the comment. The commenter also states that the commenter's objections to the originally-proposed regulations and the commenter's related attached exhibits are equally applicable to the revised regulations and are incorporated by reference within these comments.

Response to Comment:

This portion of the comment is not specifically directed at the Commissioner's proposed regulations or to the procedures followed in proposing the regulations. Additionally, this portion of the comment reflects summaries of comments that are summarized and responded to in greater detail below. No response is, therefore, necessary. (Government Code Sections 11346.9 9 & 11346.8(c).) To the extent that the objections set forth in the commenter's remarks on the originally-proposed draft are incorporated by reference in the commenter's remarks on the revised regulations, the Commissioner incorporates his responses to those objections by reference.

Summary of Comment (page 2-5):

This portion of the comment represents a summary of the changes proposed in the revised regulations, and lists the additional documents that the Commissioner has relied upon in proposing the revised regulations. The commenter summarizes, reiterates and again incorporates his previous comments on the originally-proposed regulations into his comments on the revised regulations.

Response to Comment:

This portion of the comment is merely a summary of the Commissioner's proposed changes and is not specifically directed at the Commissioner's proposed regulations or to the procedures followed in proposing the regulations. Additionally, this portion of the comment reflects summaries of comments that are summarized and responded to in greater detail below. No response is, therefore, necessary. (Government Code Sections 11346.9 9 & 11346.8(c).) To the extent that the objections set forth in the commenter's remarks on the originally-proposed draft are incorporated in the commenter's remarks on the revised regulations, the Commissioner incorporates his responses to those objections by reference.

Summary of Comment (page 6):

The revisions to the regulations do not cure their invalidity because case law establishes that the Commissioner cannot adopt regulations that conflict with existing law and the revised regulations are still inconsistent with Insurance Code section 12401 *et seq*.

Response to Comment:

This comment is merely a restatement of the comments submitted on the earlier draft of the proposed regulations. The Commissioner incorporates his responses to those objections by reference.

Summary of Comment (page 6):

While a factor used in the calculation of the maximum rate of return has been increased from 3.75% to 6%, this does not change the fact that the proposed regulations still set and fix title and escrow rates in violation of Insurance Code section 12401. For similar reasons, the revisions to the rollback provision and the ratemaking formula at sub-articles 3 and 4 are still in conflict with section 12401.

Response to Comment:

This comment is merely a restatement of the comments submitted on the earlier draft of the proposed regulations. The Commissioner incorporates his responses to those objections by reference.

Summary of Comment (page 6)

Because the maximum rate is still set through the use of industry averages, the regulations are invalid for the reasons set forth in the comments of Shawna Ackerman, which were filed as Exhibit A-1 to the objections filed on the original draft of the regulations.

Response to Comment

This comment is merely a restatement of the comments submitted on the earlier draft of the proposed regulations. The Commissioner incorporates his responses to those objections by reference.

Summary of Comment (page 7):

The interim rate reduction set forth in the revised regulations now set a maximum rate based on a formula that uses industry averages, in a manner that is very similar to the approach used under the permanent ratemaking formula. Because the revised interim rate reductions set rates based on industry average data, the regulations violate insurance Code section 12401 for the reasons set forth in Ms. Ackerman's Supplemental Testimony, which is attached as Exhibit A to this comment.

Response to Comment:

To the extent this comment incorporates the comments of Ms. Ackerman, the commissioner responds to those comments separately in this file. To the extent this commenter is objecting to the use of averages in setting the definition of an excessive rate, the comment is merely a restatement of the comments submitted on the earlier draft of the proposed regulations, and the Commissioner incorporates his responses to those objections by reference.

Summary of Comment (page 7-8):

The Commissioner has the discretion to determine the line past which a title rate is excessive, but must do so in a manner that does not interfere with competition or the free market. Dr. Hazleton's comments, were filed as Exhibit B to the commenter's objections on the original regulations and are attached as Exhibit JEH-A to the objections on the revised comments. Dr. Hazleton has also provided further comments on the revised regulations which are attached as Exhibit B to this comment. Dr. Hazleton's comments reinforce the Department's acknowledgement that the regulations will have a severe negative impact on the title industry and related industries. In addition to the fact that the revised regulations will stifle innovation and the quality of service, both the Department and the industry will be forced to acquire additional personnel to comply with the regulations.

Response to Comment:

The Commissioner rejects this comment. The statement that the Commissioner's determination of the line past which a rate is excessive cannot interfere with competition fails to acknowledge that the Commissioner has found that there does not exist a reasonable degree of competition. Consequently, there is no competition with which to interfere in prohibiting excessive rates. The commenter's failure to acknowledge the absence of competition renders his references to innovation, service-quality, and impact on firms irrelevant. For example, a negative impact on firms that have heretofore been able to charge excessive rates is neither surprising nor to be avoided. The commenter has proffered no evidence that title companies cannot provide good service at rates that comply with the proposed regulations. And the commenter has ignored provisions in the proposed regulations that provide for the introduction of new services and products. (See, e.g., § 2359.3.)

To the extent this comment incorporates the comments of Dr. Hazleton, the commissioner responds to those comments separately in this file. To the extent this commenter is objecting to the use of averages in setting the definition of an excessive rate, the comment is merely a restatement of the comments submitted on the earlier draft of the proposed regulations, and the Commissioner incorporates his responses to those objections by reference.

Summary of Comment (page 8):

The revised regulations effectively continue to impose a "prior approval" system of rate regulation on title insurers, in violation of Insurance Code section 12401.1. The fact that a prior approval system violates Insurance Code section 12401.1 is confirmed by the December 4, 2000 Legislative Counsel Opinion, which was attached as Exhibit C to the original objections.

Response to Comment:

This comment is merely a restatement of the comments submitted on the earlier draft of the proposed regulations. The Commissioner incorporates his responses to those objections by reference.

Summary of Comment (page 8):

Presumably, the Commissioner has concluded that the proposed regulations do not represent a prior approval system because the regulations do not require title insurers to obtain the express approval of the Commissioner prior to charging filed rates. This interpretation relies on a meaningless technicality, in that the end-result is the same: licensees are predetermined by the Commissioner and they cannot charge rates determined by the market. Moreover, the burden is shifted from the Commissioner to the insurers to show why their rates are appropriate. Thus, the regulations still conflict with Insurance Code section 12401.1.

Response to Comment:

The Commissioner rejects this comment. The commenter is simply wrong in failing to recognize the meaningful difference between a company being required to obtain the Commissioner's approval of a rate change before placing that rate into effect and a company being authorized to place a rate into effect without the Commissioner's prior approval. The commenter may wish to dismiss this difference as "meaningless" and a "technicality," but it is an important difference and the definitional difference between to recognized systems of regulation. (See, e.g., *20th Century Ins. Co. v. Garamendi* (1994) 8 Cal.4th 216, 243 fn. 1.)

Summary of Comment (page 8-9):

As is set forth in the commenter's objections to the originally proposed regulations, the revised regulations conflict with the open competition system of rating, which does not contemplate the regulation of insurance rates through state regulation. Both *Donabedian v. Mercury Ins. Co.*, (2004) 116 Cal.App.4th 968, 979 and *20th Century Ins. Co. v.*

Garamendi (1994) 8 Cal.4th 216, 273 recognize that there is a fundamental difference between the open competition pattern of rate regulation and the prior approval system. Because those cases recognize that the adoption of rate regulations is inappropriate under an open competition system of regulation, the revised regulations are beyond the Commissioner's authority.

Response to Comment:

The Commissioner rejects this comment. The Insurance Code does not provide an "open competition" system of regulation for title insurance. Rather, it provides a file-and-use system, which is neither open competition nor prior approval. (See, e.g., *20th Century Ins. Co. v. Garamendi* (1994) 8 Cal.4th 216, 243 fn. 1.)

Summary of Comment (page 9-10):

The revised regulations still conflict with Insurance Code section 12401.3's definition of an "excessive rate." Even assuming for the sake of argument that there is a lack of competition in the market, the Commissioner cannot declare a rate to be excessive unless he has first determined that the rate is unreasonably high for the services provided. As is explained in Ms. Ackerman's Supplemental Testimony attached as Exhibit A, the revised regulations mistakenly assume that a finding of "no competition" automatically renders all rates excessive.

Response to Comment:

The Commissioner rejects this comment. The commenter still fails to comprehend the difference between the finding of absence of a reasonable degree of competition in the relevant market and a finding that a given rate is unreasonably high for the services provided. The former finding is, by definition, a finding about the market as a whole and not about any given company. That finding is made in the regulations, and no further evidence regarding that finding is relevant to, or admissible in a hearing about, a specific company's rate. The latter finding is a company-specific finding, under the Insurance Code and under the proposed regulations. Contrary to the commenter's assertion, a finding of an absence of a reasonable degree of competition does not render all rates (or any rate) excessive; it simply opens the door to a finding of excessiveness, based on the rate being charged, when measured against the provisions of the proposed regulations and any other evidence that may be properly adduced at the company-specific hearing.

To the extent this comment incorporates the comments of Ms. Ackerman, the commissioner responds to those comments separately in this file.

Summary of Comment (page 10):

It is difficult to imagine that there is no rate above the industry average that is not reasonable for the services provided. Because the ratemaking formula presumes that any rate that is above the industry average is excessive, the regulations violate Insurance

Code section 12401.3. The fact that, as Ms. Ackerman states in her supplemental testimony, the Commissioner admits that he has not determined the reasonable cost of providing title insurance because he lacks the data to do so demonstrates that he lacks the key information necessary to determine an excessive rate. These deficiencies exist for both the permanent rate regulatory formula as well as the interim rate reduction formula.

Response to Comment:

This comment is merely a restatement of the comments submitted on the earlier draft of the proposed regulations. The Commissioner incorporates his responses to those objections by reference. To the extent this comment incorporates the comments of Ms. Ackerman, the commissioner responds to those comments separately in this file.

Summary of Comment (page 10-11):

The Commissioner's main basis for the revised regulations is still the Competition Report. This report is still critically flawed for the reasons noted in Dr. Hazleton's original report and his Supplemental Testimony which are attached to this comment.

Response to Comment:

This comment is merely a restatement of the comments submitted on the earlier draft of the proposed regulations. The Commissioner incorporates his responses to those objections by reference.

Summary of Comment (page 11):

The Swiss Re Sigma report does not discuss title insurance markets and therefore is irrelevant. Moreover, insofar as the report discusses insurance markets generally, it notes that capital requirements depend on risk and company specific factors as well as on the regulatory framework. As Dr. Hazleton notes, however, the regulations conflict with this generally-accepted principle because the revised regulations impose a profit factor that is determined without regard to capital requirements, the cost of capital, risk or company-specific factors.

Response to Comment:

The Commissioner rejects this comment. To the extent the commenter is claiming that there is a separate capital market for investment solely in title insurance, the commenter has proffered no evidence to support that claim, which would be contrary to economic theory and the testimony of industry economic witnesses. The reference to the effect of risk on capital requirements, commenter apparently fails to recognize that the quantum of risk presented by the title insurance business is reflected in the industry's level of capitalization, on which the proposed regulations properly rely. The commenter has failed to indicate any company-specific differences in risk that are not captured in the regulations through the kinds of products and services it sells, for which the proposed regulations, by setting different maximum rates, provide different amounts of profit.

To the extent this comment incorporates the comments of Dr. Hazleton, the commissioner responds to those comments separately in this file.

Summary of Comment (page 12):

Dr. Hazleton notes that the study conducted by the Washington Commissioner of Insurance suffers from the same malady as the Competition Report in that it assumes that all marketing efforts by title insurance firms are unnecessary and of no benefit to consumers. Moreover, the Washington Study complaints of activities that are actually permitted under Washington law, such as a law which permits firms to provide gifts of under $25. The same law also bars only benefits to producers when those benefits are paid as an inducement for placing business with a title insurer – this law does not prohibit expenditures for typical business events directed at persons who may or may not actually produce title business. The Washington study, therefore, provides no support for the Commissioner's actions.

Response to Comment:

The Commissioner rejects this comment. The commenter is incorrect in asserting that the Commissioner has found all marketing by title insurance firms to be unnecessary and of no benefit to consumers. The Commissioner has found that excessive expenditures on marketing are of no benefit to consumers and unnecessary. The proposed regulations provide for rates that fully compensate companies for reasonable marketing costs.

The Commissioner rejects the commenter's attempt to dismiss the findings of the Washington Commissioner. The sole use to which this Commissioner has put those findings is the indication that the anticompetitive conduct and absence of competition found in California exists elsewhere. Nothing in this comment indicates otherwise.

To the extent this comment incorporates the comments of Dr. Hazleton, the commissioner responds to those comments separately in this file.

Summary of Comment (page 12):

The revised regulations and the Staff Reports in support of those regulations, violate Insurance Code sections 12401.3(b) and (c) because they ignore the requirement that the Commissioner must give consideration to company-specific information and non-California experience. Instead, the Commissioner's Staff Reports reveal that the Commissioner has ignored company-specific information in favor of aggregated data, in part, because the Commissioner believes "the relevant markets are not competitive." An example of this can be found in the Commissioner's Calculation of Sales Cost Factor Staff Report, which ignores the actual levels of sales expenditures.

Response to Comment:

The Commissioner rejects this comment. The commenter still fails to acknowledge that actual levels of expenditure are not entitled to recovery in rates to the extent they are excessive. The Commissioner has found the absence of a reasonable degree of competition and the prevalence of reverse competition, which spawns excessive costs in marketing to middle-men with no benefits to consumers. The Commissioner is therefore justified in refusing to pass the actual levels of sales expenditures through to consumers.

Summary of Comment (page 13):

The revised regulations still conflict with Insurance Code section 12401.5(d) because the statistical plan is still being used to determine a maximum rate, which "fix[es], determine[es], or in any way impair[s] competitive rating or the free market."

Response to Comment:
This comment is merely a restatement of the comments submitted on the earlier draft of the proposed regulations. The Commissioner incorporates his responses to those objections by reference.

Summary of Comment (page 13-14):

The revised regulations still violate Insurance Code sections 12414.14 through 12414.16, because they continue to effectively prevent the charging of title rates without the issuing a Notice of noncompliance or holding a hearing. Moreover, rather than having the Commissioner prove that a rate is excessive in an administrative proceeding, the revised regulations still shift the burden of proof on to title licensees to establish that a rate meets the Commissioner's requirements. The Commissioner's authority does not permit such an approach.

Response to Comment:
This comment is merely a restatement of the comments submitted on the earlier draft of the proposed regulations. The Commissioner incorporates his responses to those objections by reference.

Summary of Comment (page 14):

As explained by the Statement of Deborah Pace Thorsvik, which was attached as Exhibit D to the commenter's comments on the original regulations, the statistical plan is still far too burdensome to meet the reasonableness standard of Insurance Code section 12401.5. Similarly, the Hazelton Report demonstrates that the statistical plan is overly burdensome. The revisions to the statistical plan do not relieve licensees of this burden.

Response to Comment:

To the extent that this comment is merely a restatement of the comments submitted on the earlier draft of the proposed regulations, the Commissioner incorporates his responses to those objections by reference. Because the Commissioner has found those comments not to be persuasive, he has not modified the proposed regulations in the manner urged by the commenter and the comments attached to his statement.

Summary of Comment (page 14-15):

The finding regarding a lack of competition has not been revised and, for the reasons set forth in the commenter's objections to the original draft of the regulations, the revised regulations remain invalid.

Response to Comment:

This comment is merely a restatement of the comments submitted on the earlier draft of the proposed regulations. The Commissioner incorporates his responses to those objections by reference.

Summary of Comment (page 16):

The revised regulations still do not provide any remedy against confiscatory rates. The regulations, therefore, are unconstitutional and contrary to *Calfarm Ins. Co. v. Deukmejian*, (1989) 48 Cal.3d 805, 816 and *20th Century Ins. Co. v. Garamendi* 8 Cal.4th 216, 244.

Response to Comment:

This comment is merely a restatement of the comments submitted on the earlier draft of the proposed regulations. The Commissioner incorporates his responses to those objections by reference.

SUMMARY AND RESPONSE TO COMMENT ATTACHMENTS

<u>Attachment 1: Untitled, authored by Shawna Ackerman on behalf of Land America Financial Group and signed on December 14, 2006.</u>
<u>Bates Range "Dec.comments 372-385."</u>

Summary (page 1): The commenter summarizes her background and qualifications.

Response: Because this is not a comment specifically directed at the proposed regulation text, no response is required.

Summary (page 2-3): The commenter outlines her understanding of CIC 12401.3 and Casualty Actuarial Society Ratemaking Principles.

Response: Because this is not a comment specifically directed at the proposed regulation text, no response is required.

Summary (page 3-5): It would be more reasonable to wait until the data call is complete and then use the results than to set the sales cost factor at 15%. This will allow the CDI to consider a particular insurer's past expenses specifically applicable to California when analyzing its filed rate. Using 15% violates the statute, which requires individual title insurers' expenses be considered. Even if the statute allowed using the industry average, the CDI has previously noted it doesn't know the average. The CDI has mistakenly concluded that a finding of "no competition" automatically renders all rates excessive. Section 12401.3 also requires that the rate be not unreasonably high for the insurance or other services provided. The CDI has provided no study of the services that a title insurer provides and the costs associated with those services. Nor does the CDI give a title insurer the opportunity to support the costs associated with the insurance and services it provides. The proposed regulation mimics a promulgated rate, instead of reflecting the scheme mandated by statute

Response: The Commissioner rejects this comment. The 15% figure comes from the experience of insurers writing in markets not afflicted with reverse-competition. The high commission rates and other sales costs associated with title insurance are the effects of reverse-competition. There is nothing improper about denying companies the costs associated with reverse-competition.

Each company is free to do as it will, subject to a cap. The commissioner is not requiring all companies to have the same expense provisions. In fact, a company could exceed the various expense cap provisions by accepting a lower profit or having a lower than maximum claim cost. The commissioner is not dictating how a company operates, simply establishing a maximum rate above which rates are deemed excessive. Consequently, in establishing a maximum rate, the Commissioner reasonably establishes a normative cap on certain expenses particularly susceptible to reverse competition.

The proposed regulations do not "fix" or "determine" rate levels. They define the level above which the rate is excessive. Companies are free to compete by charging any rate they wish so long as the rate is not "excessive." (Ins. Code § 12401.3.) It has long been understood that the code authorizes the Commissioner to prohibit excessive rates and that doing so does not constitute the proscribed fixing or determination of rates.

Summary (page 5): For the most recent rate hearing in Texas, removing unreasonable expenses associated with reverse competition resulted in a proposed reduction in expenses of only 0.5%. This result suggests the CDI should craft an appropriate study for California.

Response: The Commissioner rejects this comment. The treatment of reverse competition in the most recent Texas rate proceeding does not suggest a study for California. Moreover, the treatment of excess expenses resulting from reverse competition has varied over the years in Texas, including a greater percentage of disallowed expenses due to reverse competition. In addition, the expenses cited in the most recent Texas rate hearing do not consider excess personnel expenses resulting from reverse competition, which the Commissioner has found to be the most substantial portion of excess expenses resulting from reverse competition in California. Further, the Commissioner has performed appropriate studies in California, including the report on competition and analyses of special data calls.

Summary (page 6): The proposed rule considered sales costs associated with personal lines insurance in the property/casualty insurance industry. The CDI supported this choice by noting "the fact that admitted insurers writing this insurance must file their expenses on a nationwide uniform basis with state insurance departments, including the California Department of Insurance." Title insurers also file their expenses. The expense exhibit for a title insurer does not classify expenses in the same manner as that for a property/casualty insurer. By specifying a sale costs factor, the department ignores this difference. This would, in addition to contradicting the statutory scheme, result in continued practical difficulties in finding consistent reporting and illuminating data. Dictating the expense component violates 12401.3, which states that the expenses may differ to reflect different operating methods.

Response: The statutory annual statement is designed for solvency, not rate regulation and is based on statutory accounting not GAAP, as are the UTC annual audit report and proposed stat plan. In addition to being not comparable and therefore not relevant, the expense categories in the annual statement expense exhibit are too broad to provide meaningful analysis of the reasonableness of expenses or to identify expenses associated with reverse competition. The use of more refined expense reporting for title agents and title insurers is not only common in California (UTC annual audit report), but in other states that regulate title insurance rates (New Mexico, Texas, Florida for example).

The specification of a sales cost factor is consistent with the regulatory purpose embodied in the rate regulation. The stat plan will promote consistent reporting and illuminating data because of its greater detail. Moreover, the stat plan expense categories can be consolidated into the annual statement expense categories, if someone wishes to do so.

Each company is free to do as it will, subject to a cap. The commissioner is not requiring all companies to have the same expense provisions. In fact, a company could exceed the various expense cap provisions by accepting a lower profit or having a lower than maximum claim cost. The commissioner is not dictating how a company operates, simply establishing a maximum rate above which rates are deemed excessive. Further, because of reverse competition, actual historical expenses -- particularly for sales and marketing-related activities -- cannot be assumed reasonable as with other lines of insurance. Consequently, in establishing a maximum rate, the Commissioner reasonably establishes a normative cap on certain expenses particularly susceptible to reverse competition.

Summary (page 7-8): To be excessive, the rate must be unreasonably high for the insurance or other services provided. Within the first page of the July 3, 2006 Staff Report, the CDI acknowledges that it has not determined the reasonable cost of providing title insurance because it lacks the data to do so. The data needed won't be available until 2008. The commenter is unaware of any jurisdiction that prepares a rate indication based on aggregated data and applies it to individual companies except for those jurisdictions which promulgate rates. The rate reduction is still based only upon five insurers' data. Section 12401.3 requires rates and rate changes must instead be calculated based on an individual insurer's loss experience and expense data. This is what the CDI did earlier this year for homeowners insurance. The uniform rate change cannot, by definition, be giving consideration to the past and prospective loss and expense of an insurer or consider a reasonable margin for profit and contingencies. Section 12401.3(c) says expense provisions may differ to reflect the operating methods. Actuarial standards give preference to individual insurer data. Under proposition 103, insurers were given the opportunity to show that the 20% rate reduction was confiscatory.

Response: The interim rate reduction is only a fallback if the stat plan is not in place by the specified date. If by 2009 sufficient data are not available to base rates on costs derived from the statistical plan, it is reasonable to implement the interim maximum rates to protect consumers from excessive rates while the statistical plan data are obtained. The rates in 2000 are those which the companies themselves chose to use. The rate reduction allows for increased claims and expenses in the year of the reduction, so profit levels will not be substantially affected. While the rate reduction itself is uniform, it is applied to each company's rates, so the reduced rates themselves will not be uniform, but rather will be different, based on starting rates that are not identical between companies.

Summary (page 8): The interim rate reduction assumes that setting a rate change on average premium data is appropriate for an individual company. Rate indications are typically analyzed at an individual insurer level and based on that insurer's loss experience and expense data.

Response: Because the stat plan is not in place, there is no reliable source of data to analyze rate indications at the individual company level. (See above response about how annual statement data is not useful for this purpose.) If the stat plan data does not become available until later than 2009, it is reasonable to provide some rate relief in the interim, if insurers continue to reap the windfall title insurance premium from rapidly increasing real estate prices.

Summary (page 9-10): The interim rate reduction assumes all title insurers had a similar level of profit in 2000, that the level of profit for each in 2000 was a reasonable profit, and that the 2000 profit level is reasonable for 2006 and 2007. None of these assumptions are supported by the Interim Rate Reduction Report, nor is there any reason to believe that the assumptions would be supported by industry data. Page 78 of the Birnbaum report shows the differences in profit levels of the larger California title insurers. The table shows 2000 is the least profitable year in recent history and that the profit between the four companies is significantly different. The Staff Report "2005 Title Insurance 5-Years Profitability Report" also shows significantly different levels of profit.

Response: The rates charged by the companies in 2000 were their voluntary rates. The rates the companies charged in 2000 were also the same rates they charged for many years prior through both the up and down portions of the real estate market. The year 2000 saw rising interests and, thus, from a title insurer's perspective, it was a down year. Nevertheless, the fact is the industry did earn a profit in 2000. Even the least profitable company made a profit, save for an extraordinary charge unrelated to 2000 policies. (See the footnote to table 6.)

The interim rate reduction is intended to capture any windfall that may have occurred with the rapidly accelerating median real estate values since 2000. They are not intended to adjust for changes in the number of transactions due to rising or falling interest rates. Thus, the fact that 2000 profits were down due to rising interest rates and fewer transactions is immaterial.

Summary (page 10-11): The interim rate reduction assumes the CPI is appropriate for trends for title insurance fixed costs. The report concludes that all costs other than losses, premium taxes, commissions and profit are fixed, which is inappropriate and unsubstantiated. The fixed expenses would be primarily personnel, title agents, title plant maintenance and overhead. CPI measures a market basket of consumer goods and services such as food, housing and apparel. The CPI used by the CDI is nationwide which is compared against California specific real estate costs. The BLS says the CPI is the best measure for the market basket of consumer goods and services. Title insurers pay for labor, rents and other business costs, not for beef, chicken and poultry.

Response: The nationwide CPI is a reasonable proxy for title insurers' California costs. A cost of labor index would need to be adjusted for improvements in productivity, which would make the calculation unnecessarily complicated. Combining a cost of labor index with indices for the cost of rent and other business expenses would also add to the complexity of the regulation, without any assurance that the end result would be more accurate.

Summary (page 11): The interim rate reduction assumes each company has the same distribution of transactions across counties and the same average transaction amounts by county. Table 6 of the July 3, 2006 staff report shows the indicated rate change varies significantly by county. The newer report notes that the revised analysis used the statewide average premium to better reflect transaction volume in individual counties, but the revised analysis still improperly assumes an identical geographical distribution among insurers. Even assuming all other components of the CDI calculation are correct, an individual insurer would have a rate indication different from the average due to its different geographical distribution. The uniform rate reductions contravene the statute.

Response: The Commissioner rejects this comment. The interim rate reduction makes no assumptions claimed by commenter. The title interim rate reduction is a statewide rate reduction because title insurers have employed statewide rate tables since prior to 2000. Title insurers did not employ geographic rating for title insurance despite differential price appreciation in different parts of California since 2000, suggesting that differential price appreciation may have been addressed through premium split differences between title insurers and underwritten title companies. If this is the case, a uniform interim rate reduction can be handled in the same manner. In any event, title insurers will address a uniform interim rate reduction in the same manner they addressed differential price appreciation since 2000 while employing a uniform statewide rate table.

Summary (page 12): The above comments on title apply equally to escrow. Although there are three regions for the escrow rate reduction, the calculation is still flawed and assumes that each company operating within a specified region has the same distribution in the region. There are nearly 100 underwritten title companies. The escrow rate reduction is calculated based on the rates for six insurers. Using a subset of company data does not give consideration to the past and prospective loss experience, the past and prospective expenses or the reasonable margin for profit and contingencies for an individual company.

Response: The companies selected for developing the escrow interim rate reduction comprise the majority or near majority of the market in all counties and represent a reasonable sample of escrow fees and a reasonable basis for calculating average escrow fees for the purpose of tracking change in average escrow cost over time due to changes in average transaction size.

Summary (page 12-13): The statute does not allow the commissioner to fix rates. The staff reports and the proposed rule mandate a specific rate reduction, effectively setting the rates for each insurer. This is not permitted under the statute. Determining the maximum rate and numerous classification relativities is setting rates.

Response: The Commissioner rejects this comment. The proposed regulations do not "fix" or "determine" rate levels. They define the level above which the rate is excessive. Companies are free to compete by charging any rate they wish so long as the rate is not "excessive." (Ins. Code § 12401.3.) It has long been understood that the code authorizes the Commissioner to prohibit excessive rates and that doing so does not constitute the proscribed fixing or determination of rates.

To the extent the proposed regulations employ "classifications," their use is permissible because what is proscribed by statute is the fixing or determining rates by classification, not the recognition of different risk categories.

Furthermore, many of the distinctions drawn in the regulations are not classifications but the recognition of different products being sold. Plainly the determination whether a rate is excessive will properly take into account the product being sold.

Also, the proposed regulations (§ 2359.3) specifically allow for companies to introduce new policy forms, endorsements, and other services, discounts and surcharges.

Summary (page 13): Setting rates on the average fails to determine if a rate is excessive. An insurer may arrive at a rate in excess of the maximum that is not unreasonable for the services provided. The regulations do not consider an individual company's past and prospective losses and expenses and a reasonable provision for its profit and contingencies and may result in rates that are below cost for an individual insurer. It is simply incorrect to deem a rate over the average industry rate as unreasonable.

Response: The Commissioner rejects this comment. Regulation by formula based on industry-average costs has long been practiced by regulatory agencies and approved by the courts. Such a regulatory approach, including the use of formulas, was approved for property-casualty insurance under Proposition 103 was approved in *20th Century Ins. Co. v. Garamendi (*1994) 8 Cal.4th 216. There is no material difference between the statutes in their definition of what constitutes an excessive rate.
Furthermore, there is nothing unfair about regulating on the basis of average-costs. Where, as in the title and escrow markets, there is an absence of price-competition to discipline the market and to drive down costs, average observed costs are, if anything, above the reasonable costs that would occur in a competitive market and are themselves excessive. No company can fairly claim that its costs should be above the industry-average in such a market.

Attachment 2: "Testimony Regarding Proposed Title Rules Regulation File no. RH05049799," authored by Dr. Jared E. Hazleton on behalf of LandAmerica Financial Group and dated December 15, 2006.

Summary of Comment (page 2):
This portion of the testimony sets forth the commenter's affiliation, describes his educational background and professional training and experience, and states the purpose of his testimony.

Response to Comment:
This comment is not specifically directed at the agency's proposed action or to the procedures followed by the agency in proposing or adopting the action, so no response is necessary. (Gov. Code section 11346.9(a)(3).)

Summary of Comment (pages 4-7):
Commenter summarizes his findings regarding the Birnbaum report, concluding that the report:

- Fails to make clear that title insurance companies provide financial services, not commodities.
- Claims that the products are homogeneous.
- Erroneously assumes that demand elasticity means that the industry has no incentive to maintain reasonable prices.

- Ignores the competitive forces in the title insurance and escrow markets and focuses instead on the degree of concentration measured by the Herfindahl-Hirschman Index, which is no longer viewed by economists as a direct measure of competition.
- Assumes that the industry exhibits "reverse competition." This term was first introduced in a 1977 U.S. Department of Justice report, which was not based on an independent analysis of title insurance markets, and which noted that the "problem may not be universal for all title insurers" and concluded that "further study" of reverse competition was necessary.
- Broadens the concept of reverse competition from what was intended in the 1977 DOJ report to condemn the normal competitive behavior of title companies in marketing through intermediaries, a common phenomenon in American business.
- Relies on the 1977 DOJ report to support its allegation that controlled business arrangements are anticompetitive, even though the DOJ has withdrawn its reliance on its 1977 report in a letter to Congress.
- Uses return on equity (ROE) measures for the major title insurers, but does not disclose the underlying data, profits of the underwritten title companies, which makes it impossible to verify the report's conclusions as to profitability. The report also ignores the fact that profits of affiliated underwritten title companies and direct operations are already included in the overall ROE for the major title insurers.
- Is entirely subjective and fails to meet the minimum requirements for objective credible research. Its methodology is flawed and its analysis is weak and not supported by the facts.

Response to Comment:
The comment repeats a comment submitted in August, 2006. This comment does not regard the changes noticed on November 27, 2006, so no response is required. (Gov. Code section 11346.8(c).)

Summary of Comment (pages 7-11):
Commenter summarizes the principal points he made in his August 2006 testimony.

Response to Comment:
This comment does not regard the changes noticed on November 27, 2006, so no response is required. (Gov. Code section 11346.8(c).)

Summary of Comment (page 11):
Commenter complains that for the most part, the alterations to the proposed regulations did not address the concerns raised at the August 30 hearing.

Response to Comment:
To the extent the commenter addresses the changes noticed on November 27, 2006, those comments are addressed below.

Summary of Comment (pages 11-13):

The article "Insurers' Cost of Capital and Economic Value Creation: Principles and Practical Implications, Swiss Re Sigma No. 3/2005 (May 2005), which the Department relied on in proposing the rulemaking action, contains no information or analysis of title insurance markets, so the commenter concludes that its relevance to the proposed regulation is "tenuous at best." This article cautions that in order to judge ultimate profitability, further information is required, such as the amount and cost of capital needed to write the business. The profit factor in the proposed regulations does not take into account capital requirements, the cost of capital, risk, and company-specific factors, and is therefore arbitrarily determined.

Response to Comment:
The Commissioner rejects this comment. To the extent the commenter is arguing for company-specific calculation of the maximum rate-of-return, the Commissioner rejects that assertion. The Sigma report is included in the file because it represents a methodology and conclusion at odds with industry commenters in this file about how to determine cost of capital.

Summary of Comment (page 13):
The Department also relied on the article "An Investigation into the Use of Incentives and Inducements by Title Insurance Companies," Washington State Office of the Insurance Commissioner (October 2006). This study, like the Birnbaum report, assumes reverse competition and alleges that virtually all marketing efforts by title insurance firms are unnecessary and of no benefit to consumers. The study labels marketing efforts by title companies as being unjustified and improper even when such efforts comply with the relevant law and regulations of the State of Washington.

Response to Comment:
The Commissioner rejects this comment. The report does not make assumptions about marketing efforts and reverse competition, but reports on actual marketing efforts uncovered by Department investigations and concludes these illegal activities are a result of the reverse competitive market structure. The fact that an activity may be legal does not mean the activity is beneficial to consumers. While affiliated business arrangements are legal and may be beneficial to consumers in certain circumstances, such arrangements have increased costs in the California title insurance industry and contributed to excessive prices paid by consumers.

Summary of Comment (pages 13-14):
Marketing to intermediaries is a common phenomenon to our economy. For example, textbook publishers primarily market their products to professors rather than students; until recently, the pharmaceutical industry marketed largely to doctors rather than patients; and manufacturing industries often market purchasing agents rather than ultimate consumers.

Response to Comment:

The commenter repeats a comment previously submitted in August 2005. This comment does not regard the changes noticed on November 27, 2006, so no response is required. (Gov. Code section 11346.8(c).)

Summary of Comment (pages 14-15):
Economists recognize that consumers benefit from indirect marketing efforts aimed at intermediaries. Some consumers may not be able to or may not want to perfectly evaluate the quality of non-homogeneous products offered by sellers, which can permit a "lemons market" to emerge. But this can be prevented by relying on trusted intermediaries with experience and knowledge about the quality of the products.

Response to Comment:
The commenter repeats a comment previously submitted in August 2005. This comment does not regard the changes noticed on November 27, 2006, so no response is required. (Gov. Code section 11346.8(c).)

Summary of Comment (pages 15-16):
Product differentiation in the title insurance market is an important dimension of competition, and provides value to consumers. And direct and indirect marketing efforts help inform consumers of this product differentiation.

Response to Comment:
The commenter repeats a comment previously submitted in August 2005. This comment does not regard the changes noticed on November 27, 2006, so no response is required. (Gov. Code section 11346.8(c).)

Summary of Comment (page 16):
Because of the expertise required to determine the quality of service in the title insurance industry, marketing through intermediaries is more efficient and cost effective. Many consumers do not choose their own title insurance company, which provides *prima facie* evidence that consumers believe it is cost effective to rely on intermediaries. The experience with pharmaceutical companies further evidences that using intermediaries is more cost effective.

Response to Comment:
The commenter repeats a comment previously submitted in August 2005. This comment does not regard the changes noticed on November 27, 2006, so no response is required. (Gov. Code section 11346.8(c).)

Summary of Comment (pages 16-17):
Modest and legal expenditures incurred by title insurance firms for indirect marketing to intermediaries are made to strengthen business relationships and are a normal and accepted way of doing business; they are not attempts to buy the business. Intermediaries have a strong incentive to recommend title companies that provide the highest quality of product, and this incentive is not affected by such expenditures by title insurance firms.

Response to Comment:
The commenter repeats a comment previously submitted in August 2005. This comment does not regard the changes noticed on November 27, 2006, so no response is required. (Gov. Code section 11346.8(c).)

Summary of Comment (pages 17-18):
Selling costs and other expenses that title companies incur to differentiate their product improve the perceived quality of the product, thereby providing significant benefits to consumers. If firms are prohibited from marketing to intermediaries, they will not be able to inform consumers of these improvements and will have no incentive to offer higher quality products. The result will be to force all firms in the market to offer the same (lower quality) product.

Response to Comment:
The commenter repeats a comment previously submitted in August 2005. This comment does not regard the changes noticed on November 27, 2006, so no response is required. (Gov. Code section 11346.8(c).)

Summary of Comment (page 18):
The revised profit factor, while more reasonable than the original, is still arbitrary and potentially capricious because it does not consider evidence as to the cost of capital, the nature of the risks, and capital market expectations. It also fails to recognize that individual firms may have very different capital requirements.

Response to Comment:
The Commissioner rejects this comment. The fact remains that the calculation of a reasonable rate of return is routinely derived in regulated industries by reference to other companies and other industries. Having found the absence of a reasonable degree of competition and the existence of reverse competition in the title industry, it was reasonable for the Commissioner to look to the returns elsewhere for a benchmark for the reasonable returns in the title business. P/C lines of insurance are clearly more apt comparison than unrelated industries, given the similar nature of state insurance regulation and insurance principles. Use of market-capital to determine profit is circular, since the higher the recognized capital the higher the return and the greater the market value of the investment. Furthermore, in the long run book value and market value tend to converge. And, in fact, the courts have consistently rejected the claim that a regulated entity is entitled to market-based returns. (E.g., *Permian Basin Area Rate Cases* (1968) 390 U.S. 747, 769; *20th Century Ins. Co. v. Garamendi* (1994) 8 Cal.4th 216, 320-321; cf. *id.* at 301-302 [authorizing use of statutory capital rather than GAAP capital].) The suggestion that the proposed regulations employ different risk premia for title and escrow is rejected, since the escrow business subject to the proposed regulations is conducted by title companies or their affiliates.

Summary of Comment (page 19):
The proposed regulations are an attempt to extend detailed, burdensome, and costly public utility-type regulation to an industry that is competitive. The proposed

regulations' one-size-fits-all approach ignores the market realities in California. This will result in some firms exiting the market, leaving consumers with less choice.

Response to Comment:
The commenter repeats a comment previously submitted in August 2005. This comment does not regard the changes noticed on November 27, 2006, so no response is required. (Gov. Code section 11346.8(c).)

Summary of Comment (page 19):
The proposed regulation will stifle innovation, lower the overall quality of the services being provided, and will be costly to the State and to title insurance firms. There is evidence that under this type of regulation, efficiency goes down, quality of service goes down, and expenses to meet the demands of regulators go up.

Response to Comment:
The commenter repeats a comment previously submitted in August 2005. This comment does not regard the changes noticed on November 27, 2006, so no response is required. (Gov. Code section 11346.8(c).)

Summary of Comment:
The remaining pages consist of commenter's resume listing his qualifications and experience.

Response to Comment:
This portion of the comment is not specifically directed at the Commissioner's proposed regulations or to the procedures followed in proposing the regulations. No response is, therefore, necessary. (Gov. Code section 11346.9.)

Attachment 3: "Review and Comment on 'An Analysis of Competition in the California Title Insurance and Escrow Industry' by Birny Birnbaum," authored by Dr. Jared E. Hazleton (undated).

Summary of Comment (pages 1-2, Section I.A):
This portion of the comment sets forth commenter's affiliation and summarizes his conclusions about the Birnbaum report. Although admitting that his review is preliminary because he did not have access to much of the data and information relied upon in the Birnbaum report, commenter believes that the Birnbaum report falls far short of meeting the professional standards of economists for conducting a competition analysis for a number of reasons.

Response to Comment: This comment summarizes other comments which are presented in detail below. The Commissioner will respond to the detailed comments and there is no need to respond to the summary.

Summary of Comment (page 2, Section I.B):
This portion of the comment sets forth commenter's personal qualifications.

Response to Comment:
This portion of the comment is not specifically directed at the Commissioner's proposed regulations or to the procedures followed in proposing the regulations. No response is, therefore, necessary. (Gov. Code section 11346.9.)

Summary of Comment (pages 2-3, Section I.C):
The Birnbaum report relies on the market structure-conduct-performance methodology, an approach that has three major limitations: (1) it is inherently static; (2) it fails to consider strategic implications of the interdependency in which firms must consider the reactions of their competitors in adopting their own competitive strategies; and (3) its conclusions regarding the workability of competition are not based on science but on value judgments. The Birnbaum report also fails to make use of recent research and newer methodologies for analyzing competition, is preoccupied with concentration ratios and Herfindahl-Hirschman indices, fails recognize implications of product differentiation, incompletely analyzes barriers to entry, and relies on returns on equity based on accounting conventions to judge competitiveness.

Response to Comment:
The Commissioner rejects this comment. The Birnbaum Report discusses the market structure performance methodology but does not rely upon it. The Birnbaum Report references the Department of Justice Merger Guidelines and is consistent with standards for competition analysis of insurance markets as codified by the National Association of Insurance Commissioners in model laws on regulation of property casualty insurance. In addition, the conclusions of the Birnbaum Report are consistent with many other studies of competition in title insurance markets by independent analysts.

Summary of Comment (pages 3-4, Section II.A):
The problem with how the Birnbaum report defines the product market is that it fails to make clear that the products being provided are financial services, not commodities, and fails to indicate that some firms provide all services, while others provide only a subset of services. In defining the geographic market, the report also fails to make clear that the basis for differentiating one local market from another is not only geographic distance, but also jurisdictional independence. Title search and examination are tied to the records of local jurisdictions and their record systems which make each local market unique.

Response to Comment:
The Commissioner rejects this comment. The commenter is incorrect. The Birnbaum Report addresses each item the commenter claims the Birnbaum Report does not address

Summary of Comment (pages 4-6, Section II.B):
The Birnbaum report incorrectly describes the product as being homogeneous. Title insurance and escrow services are differentiated (and not homogeneous) in a number of ways: by the mix of services being provided, by the timeliness of the delivery, by the accuracy of the products, by intangible factors such as convenience and efficiency, and by jurisdictional differences in the availability and extent of records required for title

research and clearing. The Birnbaum report, however, defines competition solely on the basis of price and ignores non-price competition.

Response to Comment:
The Commissioner rejects this comment. To the consumer purchasing title insurance and escrow services, there is little differentiation among providers in products and services and little, if any, competition for the paying consumer based on product and service differentials.

Summary of Comment (pages 6-7, Section II.C):
The Birnbaum report's conclusion that the demand inelasticity means that sellers, as a group or individually, could raise the price of title insurance and escrow services without a decline in the quantity of title insurance policies or escrow services demanded is inconsistent with the report's characterization of the product as being homogeneous. In addition, the report's conclusion is also incorrect because in situations with a limited number of firms, producing differentiated products, each believes that if it lowers its price it can capture some but not all sales from other firms, and if it raises its price it will lose some but not all of its customers.

Response to Comment:
The Commissioner rejects this argument. There is no contradiction between inelastic demand and a homogenous product, and the commenter fails to explain why he believes such a contradiction exists. The commenter's hypothetical argument about a market with limited firms and differentiated products is inapplicable because title insurance escrow products show little differentiation.

Summary of Comment (pages 7-8, Section II.D):
The Birnbaum report alleges that the level of industry concentration in the title insurance and escrow services market measured by market share is inconsistent with competitive markets. But economists recognize that market shares, by themselves, say nothing about the extent of industry competition. Further, the Birnbaum report understates the degree of competition in these markets because it combines affiliated underwritten title companies with their parent insurers into insurer groups. There is significant competition within such groups, which the report fails to account for. Instead, the report focuses on the degree of concentration as measured by the Herfindahl-Hirschman Index, which is not an adequate measure of competition.

Response to Comment:
The Commissioner rejects this comment. HHI continues to be the standard measure of market concentration. The federal Department of Justice, the Federal Trade Commission, and the National Association of Attorneys General all continue to use HHI measurements in their analysis of horizontal mergers. In addition, Birnbaum used the HHI as only one indicator of competition and market structure, among several others. HHI is not only an important measure of market concentration, it is the most well-accepted measure of market concentration, having replaced four- and eight-firm market shares.

Summary of Comment (page 8, Section II.D):
The Birnbaum report does not provide evidence as to the number of suppliers of escrow and other services and their relative market shares.

Response to Comment:
The Commissioner rejects this comment. In all but six Southern California counties where so-called independent escrow companies operate, the providers of escrow services are predominantly underwritten title companies and, to a lesser extent, title insurers. The Birnbaum Report's analysis of title insurance market concentration is a reasonable proxy for escrow market concentration in the vast majority of counties.

Summary of Comment (page 9-10, Section II.E):
This section of the comment discusses and criticizes the Birnbaum report's analysis of industry's entry and exit statistics:

- The report does not provide an analysis of the reasons why title insurers have not entered the market, and instead observes that there has been considerable consolidation and growth in concentration in the industry. This indicates that whatever is causing consolidation among title insurers is not related to competitive conditions in California.
- The report also observes that the gradual decline in the number of established California underwritten title companies is a result of national title insurers acquiring and incorporating local companies; this means that the acquired companies remain in the market and still vigorously compete for business.
- The report's conclusion that the increase in new underwritten title companies is small and has been created by controlled business arrangements is not supported by actual data, but rather by non-public information that is not provided.
- The report's assertion that there has been limited entry into the market needs an analysis of entry conditions.
- The report fails to provide any evidence to support its conclusion that the only barrier to entry into the industry is established business relationships between underwritten title insurance companies and real estate brokers, lenders, homebuilders, and mortgage brokers. These business relationships can be obtained simply by hiring individuals who have such relationships, and given the large number of brokers, lenders, etc. there is an amply supply of this critical resource.
- The report fails to consider the licensing requirement as a potential barrier to entry, which could be one way to improve competition in the industry.
- The report's failure to provide persuasive evidence of the existence of significant barriers to entry casts doubt on its allegation of excessive profits and indicates that concentration in the industry does not preclude "reasonable" competition. The evidence in the industry indicates that the market is contestable because barriers to entry are nonexistent or low.

Response to Comment:

The Commissioner rejects this comment. The Birnbaum Report explains that the absence of title insurance entrants as a result of the main barrier to entry – access to referrers of business. The commenter is incorrect that an absence of entries is not related to competitive conditions. A fundamental criterion for competition is ease of entry and exit and the absence of entries indicates some difficulty in entry. The report also discusses underwritten title company entries and notes that all new entries were affiliated business arrangements that added no new supply to the market but enabled incumbent title insurers to lock up referral business from the affiliate partner. These results corroborate the Report's conclusion that access to referrals is the key barrier to entry. The commenter is incorrect that the Birnbaum Report fails to discuss other barriers to entry. The Report discusses access to title plants, including the difference between ownership of a title plant and subscription access, the monoline company requirement for title insurers and other licensing requirements. The plain evidence on entries – no title insurers and only affiliated underwritten title companies – coupled with ongoing acquisitions of unaffiliated underwritten title companies by national title insurers – indicates barriers to entry based mainly on access to referrals and established business relationships.

Summary of Comment (pages 11-12, Section III.A):
The Birnbaum report relies on the concept of reverse competition, but that concept is not a recognized term in the economics profession. The term reverse competition originated in a 1977 Department of Justice study, a study that presents no independently developed economic analysis of the industry, contains neither a description of the relevant product nor a definition of the relevant market, provides no information on the number of suppliers, fails to consider conditions of entry and exit, and contains no analysis of pricing or profits in the industry. Also, the 1977 DOJ study notes that the problem of reverse competition may not be universal for all title insurers and consequently, further study is required. Nevertheless, the Birnbaum report and other similar reports fail to provide more than a cursory description of the competitive forces in title and escrow services markets.

Response to Comment:
The Commissioner rejects this comment. "Reverse competition" is a well-established concept in insurance economics and has been used to describe the market structure of title insurance and credit insurance markets for at least 30 years. The term has been used, in reference to title insurance, for nearly 30 years, apparently first having been coined by the 1977 Department of Justice study. Since then, it was repeated in several other studies, including the Peat Marwick report for HUD and the California Insurance Commissioner's Bulletin 80-12. The term has been codified in regulations, including the New York State credit insurance regulation and has been used and defined in work products of the National Association of Insurance Commissioners. The time has past when the industry could credibly object to the phrase "reverse competition."

Summary of Comment (pages 13, Section III.A):
Marketing to intermediaries is a common phenomenon to our economy. For example, textbook publishers primarily market their products to professors rather than students; until recently, the pharmaceutical industry marketed largely to doctors rather than

patients; and manufacturing industries often market purchasing agents rather than ultimate consumers.

Response to Comment:
The Commissioner rejects this comment. The commenter mischaracterizes reverse competition. Reverse competition does not refer to consumers seeking advice of third parties; it refers to a market structure in which the seller markets the product to a third party who refers the paying customer to the seller, the consequence of which is that the referrer of the business has the market power and is able to extract considerations from the seller who passes the cost of the considerations onto the paying consumer who has no market power to discipline the pricing of the seller.

Summary of Comment (page 14, Section III.A):
It is not necessarily true that decisions regarding title insurance and escrow services are made by intermediaries rather than consumers. These services are often purchased by real estate professionals who know the market and have a vested interest in achieving the lowest possible price. As long these individuals are able to exert influence, competition may occur, even if most consumers are not price-sensitive and knowledgeable.

Response to Comment:
The Commissioner rejects this comment. The commenter has provided no evidence to indicate the real estate professional has the consumer's best interest in mind when it comes to escrow or title products or does not have a conflict of interest because of a financial relationship with a title insurer or underwritten title company. The frequency of illegal kickback enforcement actions against these intermediaries, as well as the legalized form of kickbacks via affiliated business arrangements that align the interest of the intermediary with the title insurer provide evidence contradicting the commenter's claims.

Summary of Comment (pages 14-15, Section III.A):
Reverse competition incorrectly assumes that marketing efforts of title insurance and escrow services firms produce little or no benefit to consumers. Firms selling differentiated products under conditions of intense rivalry with few sellers have incentives to advertise and market. Title insurers have an incentive to provide higher quality product in order to attract more business. To the extent that advertising presents information of use to consumers, it promotes a more competitive market. To the extent it persuades consumers to purchase more of a product, it can expand the market, enabling producers to reap the benefits of economies of scale. Efforts by title insurers to differentiate their product frequently provide value to consumers, enhancing the perceived quality of the service.

Response to Comment:
The Commissioner rejects this comment. The hypothetical benefits imagined by the commenter have not appeared in title and escrow markets. Reverse competition, as the Birnbaum Report documents in great detail, has led to excessive sales and marketing expenditures in the competition for the referrals from intermediaries. The captive

reinsurance scheme is a vivid example. Title insurers were willing to give almost half of the premium to homebuilders to secure the title business. Instead of pricing the product at the cost of production, title insurers kept prices inflated and passed the excess revenue or profit to homebuilders as a kickback.

Summary of Comment (pages 15-16, Section III.A):
Reverse competition assumes that title insurers can pass forward cost increases to consumers. There are a number of reasons why this assumption that title insurers are monopolists with total market power is incorrect:

- The intense rivalry noted by the Birnbaum report would not exist if these firms were monopolists.
- Knowledgeable and experienced intermediaries restrain the actions of suppliers.
- Because barriers to entry are low, raising prices is likely to induce entry; and there are large title insurers not represented in California that are potential entrants, as are local insurers that may expand operations to nearby jurisdictions.

Response to Comment:
The Commissioner rejects this comment. It is the intense competition for business referrals – directed at intermediaries – that causes increased expenditures for sales and marketing. The increased expenditures could only be supported by higher prices if consumers were unable to exert price discipline on title insurers, which is the case. The previously cited example of the captive reinsurance schemes refutes the commenter's claims as does the actual evidence of few market entries indicating barriers to entry.

Summary of Comment (pages 16-17, Section III.A):
Reverse competition assumes that intermediaries can extort favors from suppliers of title insurance and escrow services. But empirical evidence shows that reverse competition is limited in extent and sporadic, and those instances in which it does occur are extremely small compared to the large number and dollar volume of title transactions conducted each year. Moreover, economic theory indicates that reverse competition is not an effective competitive strategy. The most effective public policy for combating these isolated instances is to enforce the law, which prohibits such inducements for referrals. The Birnbaum report alleges that when title companies incur costs to improve services they harm consumers.

Response to Comment:
The Commissioner rejects this comment. The commenter appears to be ignoring the reality of frequent enforcement actions for illegal kickbacks and instances of legalized kickback, such as affiliated business arrangements and routine free services to real estate agents. The commenter has not shown that the impacts of reverse competition are limited and sporadic. The commenter is also incorrect about the theory of reverse competition and law enforcement. No amount of law enforcement will be able to overcome powerful economic incentives based on a market structure that make the intermediary the most powerful player in the market at the same time the intermediary is insensitive to the price paid by the ultimate consumers.

Summary of Comment (page 17, Section III.A):
Reverse competition assumes that prices paid by consumers are higher than they would otherwise be. But neither the Birnbaum report nor any other study provides evidence that reverse competition has raised prices. The Birnbaum report does not discuss what pricing would be without marketing to intermediaries. Without such marketing, consumers would have to incur significant costs to determine which supplier to chose. The fact that consumers decide not to incur such costs shows that they believe that reliance on intermediaries is cost effective. The experience with pharmaceutical companies, which now heavily advertise on television and in magazines, further evidences that using intermediaries is more cost effective.

Response to Comment:
The Commissioner rejects this comment. The Birnbaum Report cites numerous examples of illegal and legal activities that raise expenses of title insurers and underwritten title companies and, consequently, prices to consumers. The commenter has mischaracterized the Birnbaum Report.

Summary of Comment (pages 17-18, Section III.A):
The decision of some regulators to simply disallow a proportion of expenses in calculating title insurance base rates because they cannot determine which expenditures produce benefits to consumers and which do not is arbitrary and capricious. Reducing the rates for title insurance to penalize the industry for the illegal actions of a few of its members is arbitrary and could result in diminution of profits endangering the ability of providers to attract capital and remain in business.

Response to Comment:
The Commissioner rejects this comment. It is unclear what regulators the commenter is referring to. However, limiting certain expenses susceptible to excess because of reverse competition addresses a market failure and does not penalize the industry for the actions of a few.

Summary of Comment (pages 18-19, Section III.B):
Controlled business arrangements pose a major difficulty for the Birnbaum report. The California Insurance Code permits a controlled business arrangement as long as no more than half of the title company orders result from controlled business sources. But under the assumptions of reverse competition, these arrangements would of necessity have to be seen as raising prices to consumers without any commensurate benefit.

Response to Comment:
The Commissioner rejects this comment. It is unclear what the commenter means by posing a difficulty for the Birnbaum Report. The fact that affiliated business arrangements are legal does not equate to universal benefit to consumers of such arrangements. In the same way that monoline requirements for title insurers are intended as a consumer protection, the restriction is a barrier to entry that could harm consumers by limiting potential competitors.

Summary of Comment (page 19, Section III.B):
The Birnbaum report asserts that instances in which illegal rebating is found or in which there is only one title company in a county indicate the absence of a reasonable degree of competition, even with no controlled business arrangements present. This statement suggests that in markets with more than one title company present and in which illegal rebating is not found, even in the absence of a controlled business arrangements there must be a presumption that a reasonable degree of competition exists.

Response to Comment:
The Commissioner rejects this comment. The commenter has mischaracterized the Birnbaum Report and the comment is predicated on the mischaracterization. Since the predicate for the comment is incorrect, there is no basis for the conclusion.

Summary of Comment (page 19, Section III.B):
The Birnbaum report equates illegal rebating to the absence of a reasonable degree of competition. But it fails to explain how widespread illegal rebating must be to justify that conclusion.

Response to Comment:
The Commissioner rejects this comment. The presence of illegal rebating is one of many factors relied upon for the conclusions in the Birnbaum report, including market concentration, profitability, entries and exits and the basic reverse competitive structure of the markets.

Summary of Comment (pages 19-20, Section III.B):
A 1983 U.S. D.O.J. letter discusses the beneficial economic impacts to consumers of controlled business arrangements; for example, it states that to the extent that there is competition among providers, referral fees or other similar payments that a provider receives (perhaps because of the controlled business arrangements) are likely to be passed on (because of the forces of competition) partly or wholly to consumers. These conclusions cast doubt on the validity of applying the reverse competition paradigm to title insurance and escrow services markets, and suggest that the D.O.J. does not accept the assumptions of reverse competition as applying to title insurance and escrow services markets.

Response to Comment:
The Commissioner rejects this comment. While affiliated or controlled business arrangements have theoretical benefits for consumers and may have actual benefits for consumers in some circumstances, the Birnbaum Report describes instances where such arrangements do not benefit consumers.

Summary of Comment (pages 20-21, Section III.C):
The Birnbaum report concludes that the absence of diversity among filed rates of major insurers indicates a lack of competition. But the report also asserts that the product being sold is homogeneous, and under such conditions, there could be no price differences

among competitors. The report is being internally inconsistent in assessing the degree of competition in terms of price differences among suppliers. If the product is homogeneous, it is inappropriate to assess the state of competition on the basis of the extent of price differences. If there are price differences, then the product is not homogeneous and any assessment of competition should include both price and non-price factors.

Response to Comment:
The Commissioner rejects this comment. The commenter mischaracterizes the Birnbaum Report conclusion about base rate changes over time. The Birnbaum Report analyzed rate filings and rate changes over time and found not only little diversity among insurers in price, but virtually no change over time. In fact, the changes that did occur were rate increases for companies after a merger to make the acquired company's prices equal to the acquiring company's prices. The absence of price competition was evidenced solely not by a narrow range of prices among insurers at a particular point in time, but by the absence of change over time and the absence of any company to use a price change as a method for gaining more market share.

Summary of Comment (page 21, Section III.C):
The product being sold by title insurance and escrow services companies is not homogeneous, but differentiated, so one might expect some price differences among competitors. The Birnbaum report shows that the base rate premiums filed by major insurers did have slight variations. (Charts 6 and 7 in the report mischaracterize the data by exaggerating the flatness of rates.) The report significantly understates the actual extent of price differences because it (1) includes only the base rates of major insurers, not of other insurers; and (2) ignores the fact that much of the price competition in the market occurs though filing of special rates that offer discounts form the base rate, which is especially true with respect to refinancing transactions.

Response to Comment:
The Commissioner rejects this comment. The inclusion of other smaller title insurers in the price comparison would have no probative value. Some of the title insurers serve only the market of their affiliated business and, consequently are not competitors to the major insurers. Other title insurers are so small as to have no impact on the market. The claim about price competition is based on the filing of various discounts by insurers. The Commissioner has found that the majority of discounts is narrowly applied and has limited impact. The Commissioner has also found that title insurers misrepresent the impact of rate filings. For example, in December 2005, a Fidelity company filed rates and claimed the filing represented an overall rate decrease greater than 20%. Upon review by the Department, the rate impact was actually an increase of 1% to 2%.

Summary of Comment (pages 21-22, Section III.C):
The Birnbaum report is incorrect that the fact prices for title insurance have not changed over time even though the volume of premiums varies widely year-to-year shows that there is not reasonable competition. First, the data used by the report pertain only to filed base rates, which may differ from what consumers actually pay. Also, it is not true that

these rates should fall in good years and rise in bad years. Economic theory would suggest just the opposite: When demand falls, prices fall, and in periods of slow real estate activity and declining home values, insurers would lower, not raise, rates. The report's conclusion that rates should have fallen to reflect lower costs of production per unit sold reflects a misconception of confusing average and marginal costs.

Response to Comment:
The Commissioner rejects this comment. It is unclear how the commenter can argue that when the cost of providing a product declines, the price should increase. This seems inconsistent with the workings of a competitive market. Given that title insurers claim much of their expenses are fixed costs, the average and marginal costs of title insurance decline as volume grows. It is therefore logical and consistent with economic principles that prices should decline when transaction volume grows dramatically. When growth in transaction volume is coupled with rapid growth in transaction size and prices are a function of transaction size, but costs are not, there is even more reason to expect prices to have come down over the 2000 to 2005 period.

Summary of Comment (pages 22-23, Section III.C):
The Birnbaum report argues that costs of production have fallen based on A.M. Best reports commenting on the benefits of improved technology. These reports do not prove that industry costs have fallen. The Birnbaum report draws these conclusions regarding industry costs without analyzing the actual date, which is available from the Department of Insurance.

The Birnbaum report alleges that stable prices in the face of declining costs prove that the industry is noncompetitive. But stable prices would be consistent with a competitive industry with an elastic supply curve and expanding demand. An elastic supply curve means that when demand rises, either new firms enter or exiting firms expand capacity without incurring higher average costs. This implies an absence of barriers to entry.

Response to Comment:
The Commissioner rejects this comment. The report cited by the Birnbaum Report was produced by the American Land Title Association – the national trade association of title insurers – and the A.M. Best Company – an organization that rates the investment potential and solvency of insurers. It is reasonable to rely upon such a report for the conclusion that costs have decreased. The commenter's discussion of supply curves is misplaced. Despite the alleged implication of an absence of barriers to entry, there were no new entries of title insurers during the period of exceptional profitability and business opportunity.

Summary of Comment (page 23, Section III.C):
The Birnbaum report presents limited data on escrow fees that show significant variation, both between firms and between counties. These data reflect sensitivity and responsiveness to local market conditions in setting prices. The report concludes that a reasonable degree of competition does not exist, but that is contradicted by the data on escrow prices contained in the report.

Response to Comment:
The Commissioner rejects this comment. A key finding in the Birnbaum Report was the fact that escrow prices in Southern California are twice as high as in Northern California and have been that way for at least 25 years despite the presence of hundreds more providers of escrow services in six Southern California counties. If markets were competitive, some consumers in Northern California would want the alleged additional services of the independent escrow companies and some consumers in Southern California would want lower rates. That result has not occurred, indicating an absence of competition.

Summary of Comment (pages 23-24, Section IV.A):
The Birnbaum report states that there is insufficient information available to determine the profitability of the title insurance business, but then alleges that firms in the industry earn "excessive" profits. The report provides no basis for the asserting that the profit levels for title insurers are significantly higher than we would expect for a competitive market. In comparison to the banking industry's return on equity, the title industry's profits do not appear excessive.

Response to Comment:
The Commissioner rejects this comment. The proper standard against which to measure reasonable profitability is the cost of capital required by the title insurance company. The fact that title insurers may have earned a lower profit than other industries does not negate the fact that title insurers earned profits well in excess of the reasonable cost of capital for an extended period of time. The use of profit as a percentage of sales is not a valid measure for comparing profitability across industries because the measure does not consider the capital at risk. As stated in the response to the previous comment, the stated profitability greatly understates the actual profitability of title insurers and underwritten title companies.

Summary of Comment (page 24, Section IV.A):
The data upon which the Birnbaum report relies to determine the after-tax net income of underwritten title insurance companies was not made public. The return on equity is not always a valid measure of profitability, particularly for small firms. Also, title industry revenues vary considerably over time, due to the cyclical nature of real estate markets. The report presented profitability data for 2003 and 2004, a period of unusually high industry activity, and also presented date only on average profits. This does not properly analyze risk, for which it is necessary to have data on profits over the entire cycle, including both good and bad years. The report also fails to provide any profitability for the escrow services and other related services segments of the industry.

Response to Comment:
The only data not made public was data that was provided to the Department under statutory provisions for confidentiality. Just as it would be inappropriate for rate regulation to rely on profitable years' operations to subsidize unprofitable years, it is no

defense to excessive profits in 2003 and 2004 that the companies may have been less profitable in other years.

Summary of Comment (pages 24-25, Section V.A):
The appraisal of the workability of competition in an industry is at best a subjective judgment. But it can be informed by an extensive professional analysis of industry structure, behavior, and performance based economic theory and best available data. The Birnbaum report fails to provide such analysis. The report also fails to consider the benefits that might be achieved through regulation against costs that it imposes.

Response to Comment:
The Commissioner rejects the comment. Birnbaum was not tasked with evaluating the propriety of rate regulation. The California Legislature has made that decision. The Commissioner finds the Birnbaum Report a sound analysis of competition in business of title insurance in California and reasonable basis for concluding that a reasonable degree of competition does not exist.

Summary of Comment (pages 25-26, Section V.B):
This portion summarizes the comment.

Response to Comment:
The Commissioner has responded to the comments summarized here and need not repeat the responses.

Attachment 4: "Economic Issues Raised by Proposed Changes in the Regulation of Title Insurance in California," authored by Dr. Jared E. Hazleton and dated August 28, 2006.

Summary of Comment (page 1-2):

Commenter includes the table of contents for the report and a blank page.

Response to Comment:

This portion of the comment is not specifically directed at the Commissioner's proposed regulations or to the procedures followed in proposing the regulations, therefore no response is necessary. (Gov. Code section 11346.9.)

Summary of Comment (pages 3-7):

The commenter summarizes the detailed comments which follow.

Response to Comment:

The Commissioner has responded to the detailed comments that follow and there is no need to repeat the responses to the summary of comments.

Summary of Comment (page 8):

Commenter summarizes his qualifications.

Response to Comment:

Because this portion of the comment is not specifically directed at the Commissioner's proposed regulations or to the procedures followed in proposing the regulations, no response is necessary. (Gov. Code section 11346.9.)

Summary of Comment (page 9-12):

The commenter summarizes his understanding of the Commissioner's reasoning behind the regulations and offers some questions about market results based on economic theory. The commenter describes his view of the assumptions underlying the proposed regulations and explains what his report intends to do.

Response to Comment:

Because this portion of the comment is not specifically directed at the Commissioner's proposed regulations or to the procedures followed in proposing the regulations, no response is necessary. (Gov. Code section 11346.9.) To the extent that any of these comments are summaries of more detailed comments below, the Commissioner will respond to the detailed comments and there is no need to repeat the response here.

Summary of Comment (page 13-16):

The commenter discusses a 1964 dissertation by Joseph Brown and claims it is the only major comprehensive study of the economics of title insurance business, based on a mail survey of seven urban title insurance markets. The commenter states the Brown study found the title insurance industry workably competitive. The commenter cites merger approvals by the Federal Trade Commission as evidence that regulators found title insurance markets competitive. The commenter cites the comments of Gregory Vistnes, submitted in this proceeding to explain the actions of the FTC. The commenter argues that the FTC made the same finding as the Brown study – the title insurance industry is workably competitive.

Response to Comment:

The Commissioner rejects this comment. The commenter's selection of studies is highly selective and ignores several studies cited in the Birnbaum Report as well as the Birnbaum Report itself. The action of the FTC provides no indication of whether California title insurance markets are reasonably competitive. The standard for approval is that competition will not be harmed. The FTC makes and made no conclusion that existing markets are competitive or that price competition exists.

Summary of Comment (pages 16-17):

The commenter provides a summary distinguishing between the two basic products or services provided by title insurers: (1) a pure insurance product offered by title insurers, which includes assumption of risk for a title defect in exchange for the payment of a premium, and (2) an underwriting service that is carried out by title agents, who fall into one of three categories, and involves a title search and examination relating to defects in title.

Response to Comment:

This portion of the comment is not specifically directed at the Commissioner's proposed regulations or to the procedures followed in proposing the regulations, therefore no response is necessary. (Government Code Section 11346.9.)

Summary of Comment (pages 17-21):

The commenter provides a breakdown of title company revenue, stating that it reflects volume of title activity, mix of polices written, and the average value of the insurance provided. Additional sources of revenue are fees and other income from non-title policy activities, and investment income. The commenter then goes on regarding the sources of demand for title insurance (related to new and existing housing and the refinancing of existing mortgages) and the influences on demand, stating that demand is inelastic. Furthermore that assurance of a sound title is an essential to a real estate transaction (title insurance is present in 85 percent of residential sales transactions in the United States), barriers to entry in the title business are low --- making the market "contestable" and acts as a check against price raises from existing firms, and title markets are characterized by price and non-price competition (the uncertainty involved with a downward sloping demand curve causes firms to seek to reduce the uncertainty by differentiating their product from others). The commenter explains that each title and escrow transaction is unique and the mix of services provided is an important characteristic of the title product, that title insurance and escrow and related services have important time and accuracy dimensions, that there are intangibles such as pleasant and convenient service that adds value to consumers and makes products differentiable, and geography further makes each title transaction unique as each jurisdiction presents its own challenges regarding availability and extent of records. The commenter further summarily reiterates the various ways that title insurance and escrow services differentiate themselves, as was discussed earlier in the comments.

Response to Comment:

The Commissioner rejects this comment. Nothing in this narrative demonstrates the existence of price-competition in the relevant markets.

Summary of Comment (pages 21-23):

The proposed regulations envision a maximum rate that could be charged for title insurance and escrow services. Usually when a state sets prices for an industry there is a single geographic market, the product is homogenous, and the producer is a natural monopoly. "None of these conditions exist in the title insurance industry." First, economically, title markets are differentiated by distance and therefore the relevant geographic market for the title insurance and escrow services is the county, with some exceptions. Conditions of supply and demand differ in these numerous markets, as recognized by the Commissioner with the interim rate rollback. Second, title insurance is heterogeneous, it is differentiated by geography, timeliness, accuracy, convenience, and the mix of services provided. This differentiation means that consumers are concerned with other aspects of the product in addition to price and these differentiation related expenditures are beneficial to the consumer. Finally, there is no place in the nation where title insurance is considered to be a natural monopoly; rather competition is characterized as fierce, including in "California's market." Public utility type regulation is not justified. The industry is workably competitive therefore extensive regulation and required reporting are unnecessary and costly.

Response to Comment:

The Commissioner rejects this comment. The title and escrow products are relatively homogeneous. Nothing in economic theory or regulatory practice limits rate regulation to natural monopolies. The question is – as the statute provides – whether there is price-competition, not merely whether there is a natural monopoly.

Summary of Comment (page 23-24):

In the Commissioner's Initial Statement of Reasons he stated that the only source relied upon for his finding regarding competition was the Birnbaum report. Three independent analyses have noted major flaws in the Birnbaum report invalidating its conclusions and have also concluded that the report is inadequate and an unsuited basis upon which to make public policy decision and to take regulatory action. The independent analyses found that it relies on a fifty-year old methodology for competition that is no longer accepted by economist and is inappropriate and ridden with errors.

Response to Comment:

The Commissioner rejects this comment. The merits of the competing positions is not determined by counting the number of studies, particularly where the opposing studies come from economists retained by the industry for the purpose of opposing regulation. The Commissioner rejects the unsupported claim that the economic principles and methodology of the Competition Report are somehow obsolete. These principles and methodologies are still in use today by antitrust enforcement agencies.

Summary of Comment (page 24):

The independent analyses found that the Birnbaum report relies on a fifty-year old methodology for competition that is no longer accepted by economist and is inappropriate and ridden with errors.

Response to Comment:

The Commissioner rejects this comment. The commenter has failed to identify any errors, and, as previously noted, there is nothing obsolete about the methodology.

Summary of Comment (page 24-25):

The independent analyses also found that Birnbaum report provides misleading descriptions of important industry factors, including (1) defining the products offered by title insurance and the escrow industry as homogeneous; (2) making incorrect assumptions regarding inelasticity as it relates to demand; (3) focusing on price competition over non-price competition; (4) assessing the degree of competition based on the potential misleading review of market concentration measures; (5) inaccurately characterizing barriers to market entry; (6) misinterpreting the price behavior as evidence of no price competition; (7) failing to include an analysis of cost trends; and (8) providing little analysis of the competitive conditions in the market for escrow services.

Response to Comment:

The Commissioner rejects this comment. See Response to Common Comments C.16. The products are relatively homogeneous. The commenter has failed to identify any error concerning price-elasticity. Price-competition is the relevant issue under Insurance Code section 12401.3. The report is thorough and persuasive on market entries and barriers to entry, on pricing behavior, on cost trends, and on the escrow market.

Summary of Comment (page 25):

The independent analyses further found that because the Birnbaum report assumes the standard of "perfect competition" it does not address reasonable competition nor does it compare the California market to that standard. The conclusions regarding workability of competition in the industry are subjective because the Birnbaum report fails to consider the costs and benefits or any alternative regulatory regime.

Response to Comment:

The Commissioner rejects this comment. The report is explicit that the issue is "workable competition," not "perfect competition."

Summary of Comment (page 25):

The critiques in the independent analyses were submitted at the Department's Information Hearing in January 2006 and should have been taken into consideration in developing the proposed regulations. The Commissioner's Initial Statement of Reasons indicates his unqualified acceptance of the Birnbaum report's conclusions, despite the various concerns.

Response to Comment:

The Commissioner has considered and rejected the proffered analyses as unpersuasive.

Summary of Comment (pages 26-27):

The Birnbaum report and the Commissioner's Initial Statement of Reasons primarily rely on the "alleged existence of reverse competition" for their competition and unreasonableness of prices conclusions. The commenter provides a history of the "term reverse competition," citing to and summarizing a 1977 U.S. Department of Justice report and stating that the report limited its definition of reverse competition to payment of direct inducements to the producers of business, "actions that have subsequently become illegal under both state and federal law." Title firms' provisions of inducements to those referring business are few and far between, and are unlikely to have had a significant impact on the overall prices and profitability of the industry.

Response to Comment:

The term "reverse competition" has long been established and continues to be used in academic and governmental analyses of the title insurance markets.

Summary of Comment (page 27-28):

If the reverse competition is limited to payment of inducements to those referring business, the remedy is enforcement of existing laws and it should not affect rate setting. The broadening of reverse competition to condemn the "normal competitive behavior of title companies in marketing through intermediaries" was not the intent of the 1977 U.S. Department of Justice report. Reverse competition is not a recognized term in economics, but can be assessed using economic tools and concepts. Condemnation of the broadened concept of reverse competition rest on three assumptions that are inaccurate: (1) the consumers lack the knowledge, expertise, or interest to shop for the best price for title insurance, so firms compete for business by marketing to those whom consumers rely upon for advice and not to the ultimate consumer; (2) indirect marketing efforts do not benefit consumers; and (3) title firms have the market power to pass on indirect marketing costs to the consumer in the form of higher prices. The commenter explores these three assumptions in the later sections of his comments.

Response to Comment:

The Commissioner rejects this comment. See Response to Common Comment C.10. The problem with reverse competition is not merely with illegal rebating but with the structure and performance of the market and, in particular, that the person selecting the seller is not the person paying the bill.

Summary of Comment (page 28):

Enough consumers, including real estate professionals, are price-sensitive and are knowledgeable regarding the quality of products offered in the market. It is sufficient and enough for competition to occur that these consumers are able to exert influence.

Response to Comment:

The Commissioner rejects this comment. The overwhelming evidence supports the conclusion that there is an absence of price-sensitivity and of price-competition.

Summary of Comment (pages 29-30):

Marketing to intermediaries is a common practice in our economy. Under conditions of perfect competition there would be no incentive to advertise product or market products because producers could sell all that could be produced at the existing market price. Perfect competition assumes that consumers have all the relevant information. However, under real world market conditions, those firms selling a differentiable product under conditions of rivalry have an incentive to advertise and engage in other types of marketing. "Economists recognize that these efforts provide substantial benefits to consumers." Uniformed consumers cannot gauge quality, resulting in a "lemons market." Reliance on informed intermediaries can help inform consumers and help them avoid purchasing lemons.

Response to Comment:

The Commissioner rejects this comment. See Response to Common Comment C.13. While many markets may depend on referrals, the title market is unusual in the fact that consumers do not know they are buying the product and have no information about its costs at a time when they could do anything about it.

Summary of Comment (pages 30-31):

Marketing involves advertising, positioning of the product in the market, and product differentiation. Product differentiation is important to competition; consumers are concerned with quality and service. The quality of the product being offered in the title insurance and escrow market can be differentiated in a number of ways that were previously mentioned in the comments. To attract more business, title insurance and escrow services providers have an incentive to offer a higher quality product. Differentiation efforts provide value to consumers and marketing efforts inform consumers of the quality of the product being officers, benefiting consumers and promoting a more competitive market.

Response to Comment:

The Commissioner rejects this comment. There are no demonstrated quality differences in the title products. Consumers who pay for the product are oblivious to any claimed quality differences. The commenter has failed to demonstrate the existence of consumer benefits from the marketing practices.

Summary of Comment (page 31):

The fact that consumers of title insurance do not choose to incur significant costs by determining on their own the best source of supply is "*prima facie* evidence that reliance on intermediaries is deemed by these consumers to be cost effective."

Response to Comment:

The Commissioner rejects this comment. See Response to Common Comment C.13. The commenter proffers no evidence that consumers knowingly rely on intermediaries for the referrals.

Summary of Comment (pages 31-32):

In a market where expertise is required to determine the quality of service, it is more efficient and less costly to consumers for firms to market their products to the knowledgeable intermediaries rather than to the consumers. The pharmaceutical industry in one such industry where there is likely increased costs with recent marketing to consumers.

Response to Comment:

The Commissioner rejects this comment. See Responses to Common Comments C.12 & C.13.

Summary of Comment (page 32):

The assumptions of reverse competition imply that title insurers and escrow and related services suppliers are monopolists who have total market power and can independently determine market prices, recouping additional costs of marketing to intermediaries by raising their prices. However, knowledgeable intermediaries represent the interest of purchasers and "are in a position to restrain the actions of suppliers and promote the delivery of efficient, convenient, and cost-effective services."

Response to Comment:

The Commissioner rejects this comment. See Response to Common Comment C.13. The commenter has wholly failed to proffer any evidence of price-restraint by intermediaries – restraint that would operate against the intermediaries' financial interests.

Summary of Comment (pages 32-33):

Originally reverse competition referred to title firms making direct payment to third parties in return for referral of business. The practice of side payments results in a less efficient market and represents a conflict of interest. This practice has been appropriately addressed with "limited, targeted, regulations." The rigorous enforcement of these regulations enhances competition, ensuring that the incentives of real estate professionals and lenders are aligned with the interest of the home buyer or seller that they represent.

Response to Comment:

The Commissioner rejects this comment. See Response to Common Comment C.11. The problem with reverse competition is not merely with illegal rebates but also with legal inducements that insulate the companies from downward price pressures.

Summary of Comment (page 33):

Expanding the definition of reverse competition to encompass all efforts at marketing through third parties is not justified and is not appropriate. This type of marketing is commonplace throughout our economy and often represents a less costly and more efficient means of informing and educating consumers regarding the products offered in the market and their quality. Therefore, reverse competition "serves the interests of consumers by providing needed information and expertise and enhances competition."

Response to Comment:

The Commissioner rejects this comment. See Response to Common Comment C.11.

Summary of Comment (pages 33-34):

In his Initial Statement of Reasons, the Commissioner observes that in California the price of residential real estate rose by 48 percent between 2000 and 2005, with the median price of title insurance premiums --- as based on a sliding scale relating to the value of the transaction --- increasing by 29 percent. The Commissioner asserts that with many expenses fixed, the cost of providing title insurance has not risen as much as revenue but the title companies have not reduced their prices accordingly. Therefore the Commissioner contends that title insurers have earned excessive profits, resulting in unreasonable rates. The Commissioner's line of reasoning regarding revenue pertains only to title insurance, escrow services "are not provided on a sliding scale nor are a substantial portion of their costs fixed." The Birnbaum report and the Commissioner's Initial Statement of Reasons do not provide any analysis regarding the competitive conditions of escrow services markets to justify increased regulation of the service providers.

Response to Comment:

The Commissioner rejects this comment. On the contrary, the report's evidence on the escrow market – particularly the differences in pricing between Northern and Southern California – provide compelling evidence of the absence of competition in the escrow markets.

Summary of Comment (page 34):

There are three questions raised by the Commissioner's analysis of the economics of the title insurance and escrow services: (1) have title and escrow service providers reduced their prices during the relevant period of rising activity, is there evidence of price competition in the California title insurance and escrow services markets; (2) how do the costs of providing title insurance and escrow services vary with an increase in activity and revenue; and (3) have title and escrow services in California reaped excessive profits? (The commenter explores the answers to these questions in the next eight pages of his comments.)

Response to Comment:

This portion of the comment reflects summaries of comments that are summarized and responded to in greater detail below. No response is, therefore, necessary. (Gov. Code section 11346.9.)

Summary of Comment (page 35):

The Birnbaum report and the Commissioner's Initial Statement of Reasons assert that title companies have not reduced their prices in recent years, but this is derived only from filed base rates of major insurers and does not take into account discounts. California title companies have offered numerous rate reductions, since 2000, due to competition or the need to match the rate reductions of rivals.

Response to Comment:

The Commissioner rejects this comment. The absence of base-rate changes is itself powerful evidence of the absence of a reasonable degree of competition. The commenter has not proffered any evidence about the frequency of use and availability of the discounts to which he refers. Indeed, the existence of discounts for which only narrowly drawn parties are eligible is itself evidence of an absence of a reasonable degree of competition.

Summary of Comment (page 35-36):

The Birnbaum report significantly understates the extent of the price differences among competitors in the title insurance and escrow services industry by only including the base rates file by major insurers. This understatement is "magnified" by the report's focus on base rates to the exclusion of recognizing the occurrence of competition through the filing of special rates that offer discounts from the base rates (as often is the case with refinancing transactions).

Response to Comment:

The Commissioner rejects this comment. The lack of pricing diversity in base rates is, indeed, powerful evidence of the absence of competition. What the data show is that there is very little pricing diversity among the major companies. While there is greater pricing diversity among the smaller companies, there is no evidence that a significant number of consumers are paying the lower prices. On the contrary, the fact that the larger companies do not find it necessary to reduce their own rates to meet the lower prices confirms the absence of price competition.

Summary of Comment (pages 36-37):

The conclusion in the Birnbaum report and the Commissioner's Initial Statement of Reasons that "a reasonable degree of competition does not exist in the escrow and other related services market" is contradicted by the data on escrow services prices described in the Birnbaum report. The data in the Birnbaum report, which are select filed rates, reflect sensitivity and responsiveness to local market conditions in setting prices.

Response to Comment:

The Commissioner rejects this comment. The assertion that the enormous differences between Northern and Southern California is attributable to unspecified market conditions is unsupported. It is, of course, tautologically true that the observed market performance is a product of local market conditions. The relevant question is whether those are conditions that should be preserved. The clear inference of the wide regional disparity – for which no cost-justification has been proffered by the commenter or anyone else – is that the disparity reflects the absence of a reasonable degree of competition.

Summary of Comment (page 37-38):

There are a number of costs associated with offering title insurance, including those costs stemming from the performance of title searches and examinations, the resolving or clearing of defects to title, the payment of claim costs for title defects (there are also increased costs associated with fraud and forgery), the maintenance of title plants, and the marketing of products and services.

Response to Comment:

This comment is not specifically directed at the agency's proposed action or to the procedures followed by the agency in proposing or adopting the action, so no response is necessary. (Gov. Code section 11346.9(a)(3).)

Summary of Comment (page 38):

In his Initial Statement of Reasons the Commissioner assumes that "the only category of costs impacted directly by an increase of home values is the cost of insuring the additional liability," representing 5 percent or less of costs. The Commissioner assumes the other costs are fixed, only increasing with inflation. However, 95 percent of all title costs are not fixed. An increase in policy volume results in title companies having to open additional offices as well as purchase and maintain more computer and informational systems. Selling expenses would also be anticipated to increase and a rise in non-title insurance activities could also generate additional costs.

Response to Comment:

The Commissioner rejects this comment. The commenter has misconstrued the statement in the Initial Statement of Reasons. The roughly 5% of premium that has historically gone to losses is traditionally thought of as variable costs in a sense that the balance of the costs are not. It may well be true, for example, that industry practice has evolved to treat, for example, sales costs as strictly variable – that is, as the premium goes up, sales costs follow – but that does not necessarily justify the practice. The reality – that as the profitability of the business rises, companies spend more and more on reverse-competition to increase market share – is itself a symptom of the absence of price-competition.

Summary of Comment (page 39):

The increase in revenue from higher property values "could have been used" to finance expanded title company operations, including technological upgrades and improvements to the quality of services that would reduce net income after taxes and profitability. The Birnbaum report and the Initial Statement of Reasons do not contain an analysis of title company costs, but another means of assessing whether title company revenues have risen more than costs is to examine industry profitability. (The commenter discusses profitability of the title companies in the next four pages of his comments.)

Response to Comment:

The Commissioner rejects this comment. The commenter has proffered no evidence to refute the conclusion that the increase in revenue in excess of costs is evidence of the absence of a reasonable degree of competition.

Summary of Comment (page 39-40):

The commenter discusses the assessment and expression of profits, and states that the two "common measures of the annual profitability of a title insurer are the 'expense ratio' and the 'loss ratio'" and the sum of both ratios in "the combined ratio." "[O]ne minus the combined ratio equals the pre-tax operating margin." Low pre-tax profits, calculated as a percent of operating income, are typical for title insurers.

Response to Comment:

The Commissioner rejects this comment. Return on capital is the recognized and appropriate measure of profitability in regulated industries. Measures such as operating margins are less reliable, as the evidence for this industry shows. Since title insurers wind up giving the UTC (often an affiliated company) 90% of the revenue, and then book that 90% as an expense, it is not surprising that returns on revenue are low. Indeed, this phenomenon is confirmed by the high returns on capital booked by the UTCs, as shown in the Birnbaum report.

Summary of Comment (page 40-41):

The rate of return measures used in the Birnbaum report found that profit levels are significantly higher than what would be expected in a competitive market and higher than indicated by market-based derivations of the cost of capital. However, Yahoo finance data for public companies and the average for the Standard and Poor's 500 companies were both above the profitability range reported in the Birnbaum report. And overall, the return on equity of title insurers was not excessive compared to the average return on equity of the entire banking industry, even though the average of the entire banking industry was less. This is confirmed by a Strangle and Strombom report to the Department finding that the average net income margin, average operating margin, and average return of stockholder's equity for title insurers to be in line with similar measures for other industry groups.

Response to Comment:

The Commissioner rejects this comment. See Responses to Common Comments C.24 & C.25.

Summary of Comment (pages 41):

The Birnbaum report discussed the percentage that underwritten title companies earned after tax net income, but the data used to derive this conclusion have not been made public. Furthermore, return on equity is not always a valid measure of profitability. In those small firms providing financial services the amount of equity may be minimal and "net income often is more a return on the owners' human capital than on their financial capital."

Response to Comment:

The Commissioner rejects this comment. See Response to Common Comment C.27.

Summary of Comment (page 41-42):

The revenues of the title insurance and escrow services industry vary considerably over time, the Birnbaum report presented profitability data based on a period of "unusually high industry activity." To thoroughly analyze profitability the report needed to also analyze risk, which requires examination of profits in good and bad years and profits data by firm, and also to study the variability of returns.

Response to Comment:

The Commissioner rejects this comment. See Response to Common Comment C.25.

Summary of Comment (page 42):

The Birnbaum report did not "provide any profitability information for the escrow services and other related services segments of the industry."

Response to Comment:

The Commissioner rejects this comment. The profitability of controlled escrow companies is not readily available because the data reported to the Department does not break out the escrow business.

Summary of Comment (page 42):

The various issues related to assessing profitability demonstrate the problems with basing regulated rates on profitability, as profitability measures poorly indicate the relative degree of competition in a market and the reasonableness of price. The title insurance and escrow services market in California is competitive, therefore the price established by the market are reasonable.

Response to Comment:

The Commissioner rejects this comment. The commenter has failed to proffer any evidence to support the counter-intuitive proposition that profitability is unrelated to the absence of competition. The conclusory assertion that the industry is competitive is not persuasive.

Summary of Comment (page 43-44):

The commenter briefly summarizes what he believes was the Commissioner's initial determination regarding the economic impact of the proposed regulation. This impact would likely result in layoffs, reductions in other expenses, and reduced services to consumers. Furthermore, the detailed reports that must be generated would result in significant costs to title insurers and underwritten title companies due to expenses to collect, store, and generate the information related to the reports. The initial costs of implementation would be in the millions of dollars for major insurers and underwritten title companies. These are large fixed costs that smaller firms may not be able to bear and may cause some firms to exit the industry, harming competition. In addition, there are also maintenance and employee productivity costs, as well as necessary public expenditures related to the reports. Overall, a reduction of level and quality of services could be expected.

Response to Comment:

The Commissioner rejects this comment. See Response to Common Comment C.30.

Summary of Comment (pages 44-45):

The proposed regulations would reduce the revenue of California title firms, forcing them to reduce services and cut employment, and would also reduce the net income of underwritten title companies. This would not result a significant number of new jobs, as anticipated by the Commissioner. The financial and other losses experienced by the industry will offset most if not all of the reduction in title premiums.

Response to Comment:

The Commissioner rejects this comment. See Response to Common Comments C.30.

Summary of Comment (page 45):

The proposed regulations would only reduce "the total cost of purchasing the average house by less than 0.2 percent," not resulting in a significant decline in housing costs.

Response to Comment:

The Commissioner rejects this comment. The percentage of the cost of purchasing a home is scarcely a relevant measure. Indeed, it is precisely this small percentage of a huge transaction that helps insulate the title and escrow industry from price-competition. Assuming for purposes of this comment that the savings to consumers would be 0.2% of the median home price of over $500,000, the commenter appears to be conceding that the proposed regulations will save the consumer in the median transaction roughly $1,000. That is a saving well worth the costs of the program.

Summary of Comment (pages 45-46):

The commenter concludes his comments by stating that the California title insurance market is structurally competitive and exhibits evidence of ongoing price and non-price competition. Moreover, prices charged to consumers are reasonable and not excessive, and the industry return on equity is reasonable and in line with that of other financial firms. Finally, the proposed regulations would harm consumers and would be costly for California businesses and government.

Response to Comment:

This portion of the comment reflects summaries of comments that are summarized and responded to in greater detail above. No response is, therefore, necessary. (Government Code Section 11346.9.)

Summary of Comment (pages 47-48):

The commenter lists some of the references that he relied upon.

Response to Comment:

Because this portion of the comment is not specifically directed at the Commissioner's proposed regulations or to the procedures followed in proposing the regulations, no response is necessary. (Gov. Code section 11346.9.)

Summary of Comment (page 49-64):

The commenter attaches "Appendix A," his curriculum vita.

Response to Comment:

Because this portion of the comment is not specifically directed at the Commissioner's proposed regulations or to the procedures followed in proposing the regulations, no response is necessary. (Gov. Code section 11346.9.)

Volume 10, Comment No. "Dec.comments 513-516":

Commentator: Kirk Brown on behalf of Crescent Land Title Company (Del Norte County)
Date of Comment: Dated and received December 15, 2006
Type of Comment: Written

Summary of Comment: (p. 1)

DOI does not have the statutory power to set title insurance and escrow rates. DOI is generalizing when it says that there is no competition in the title industry and that all title companies, regardless of location, operate in the same manner. DOI's own studies and disciplinary actions show that excess profits used to steer business to a particular title company occurs mainly in urban counties, not in rural counties. Underwritten title companies in rural counties of N. California are competitive because they offer better service than their competition.

Response to Comment:

The Commissioner rejects this comment. The proposed regulations do not set rates. They define the level above which the rate is excessive. Companies are free to compete by charging any rate they wish so long as the rate is not "excessive." (Ins. Code

§ 12401.3.) The Commissioner does not assert that all title companies operate in the same manner, but he has found that they operate in the same markets and has found those markets to lack a reasonable degree of competition. The commenter has proffered no evidence to support the claim that anticompetitive conduct is limited to urban counties; in general, there are, as the Competition Report found, fewer companies operating in smaller and rural counties, which is sometimes an indicator of a lesser degree of competition (although the Commissioner has found high concentration in both urban and rural counties and no evidence of a reasonable degree of competition in either urban or rural counties). The commenter appears to concede that there is, as the Competition Report has found, no price-competition in the title markets, and the commenter has proffered no evidence that consumers benefit from whatever competition in service exists; on the contrary, what the industry refers to as service competition is intended to benefit what the title companies call their "customers," the middle-men who steer business, not the ultimate consumer who pays the premium.

Summary of Comment: (p. 2)

DOI's statistical reporting scheme is too complex. The 13 separate proposed reports extend far beyond the information currently required in annual and quarterly reports. We don't track much of the information required in the proposed reports because that information is irrelevant to day to day operations of any private business and especially of an underwritten title company. For example, it's meaningless to management to track (as required in UTC04) the percentage of time each employee contributed to an order. What's relevant is that the order is completed timely and accurately.

Response to Comment:

The Commissioner rejects this comment. The complexity of the statistical plan is a function of the regulatory task it performs. The Commissioner has found that the information currently reported in annual and quarterly reports is inadequate – both that the companies do not provide the necessary information and that what information is reported is often unreliable. Specifically with respect to report UTC04, the data is essential to the proposed regulations. Determination whether a "rate is unreasonably high for the insurance or other services provided" (Ins. Code § 12401.3) requires determination of what it reasonably costs to provide the insurance or other service. The cost of providing title and escrow services is composed to a significant degree of personnel costs. And since underwriters and UTCs sell different products and services, it is necessary to determine the personnel costs that go into each phase of providing the product or service. That is the purpose of UTC04.

Summary of Comment: (p. 2)

Reports should not be public. It's not the public's business how much we pay each employee.

Response to Comment:

The Commissioner rejects this comment. Employee costs are a major component of the cost of providing title insurance and escrow services, and therefore relevant to the determination whether a rate is excessive. The Legislature has seen fit to make the rate-regulatory process a public process, in which the public is entitled to participate.

Summary of Comment: (p. 3)

There is no software available to track the data required in the proposed reports. Crescent Land & Title wouldn't have the money to develop the software. Crescent Land & Title doesn't have an in house IT department and must rely on outside vendors for software.

Response to Comment:

The Commissioner rejects this comment. To the extent commercial software is not currently available, it is reasonable to assume that such products will become available once the reporting requirements have been enacted. Out of consideration for small companies that must depend on such off-the-shelf software, the Commissioner has amended the proposed regulations to exempt small independent UTCs from the reporting requirements until such time as necessary software or services are commercially available.

Summary of Comment: (p. 2)

There is no public outcry that title insurance and escrow rates are excessive and that the public is suffering as a result. Rates are competitive. The only reason for these regulations is to further Garamendi's aspirations to the governor's office.

Response to Comment:

The Commissioner rejects this comment. In fact, there has been enormous attention, in the general press and in the trade press, on the high costs and lack of competition in the title and escrow markets, and insurance regulators in several states have been giving the industry increasing scrutiny. The California Insurance Commissioner has found widespread and increasing illegal rebating, as have the commissioners in other states. A number of consumer organizations have filed comments in this rulemaking file supporting the proposed regulations. The Commissioner rejects the unsubstantiated, ad hominem attack on his motives.

<u>Volume 10, Comment No. "Dec.comments 517-615":</u>

Commentator: Fidelity National Title Company (LeBoeuf, Lamb, Greene & MacRae).
Date of Comment: Dated December 15, 2006, marked for hand delivery
Type of Comment: Written

<u>Summary of Comment (pages 1-2)</u>:

This passage introduces Fidelity National Financial, Inc., and identifies the attached appendix to the comment.

<u>Response to Comment</u>:

This portion of the comment is not specifically directed at the Commissioner's proposed regulations or to the procedures followed in proposing the regulations, or simply summarizes comments which are summarized and responded to in more detail below. No response is, therefore, necessary. (Gov. Code section 11346.9.)

<u>Summary of Comment (pages 2-6)</u>:

This portion of the comment presents a summary of the Proposed Regulations, and actions taken by Department regarding the Proposed Regulations, summarizes the commentator's specific remarks which are set forth in greater detail within the subsequent pages of the comment.

<u>Response to Comment</u>:

This portion of the comment is not specifically directed at the Commissioner's proposed regulations or to the procedures followed in proposing the regulations, or simply summarizes comments which are summarized and responded to in more detail below. No response is, therefore, necessary. (Gov. Code section 11346.9.)

<u>Summary of Comment (pages 6-7)</u>:

The Commissioner has secretly made a finding that title insurance rates are excessive; this finding was disclosed for the first time in the November 27, 2006 materials. The Commissioner has not disclosed the procedural steps taken to arrive at this determination or the evidence considered. The Commissioner has made this finding by fiat, in a closed-door proceeding without: 1) prior notice to affected parties; 2) hearing; 3) opportunity for the affected parties to appear, be heard, present evidence, and cross-examine witnesses on the issue of excessiveness; 4) consideration of any company-specific financial information; 5) establishment of a record a court can examine in an independent judicial review of the finding; or 6) opportunity on the part of the affected parties to independent judicial review of the finding.

This process is unlawful because it contravenes the exclusive and statutorily prescribed process by which a finding of excessiveness can be made and because it deprived affected parties of due process rights afforded under the U.S. and California Constitutions.

<u>Response to Comment</u>:

The Commissioner rejects this comment. The Commissioner has made no "secret" findings – all of the findings and their evidentiary basis are found in this rulemaking file, in which the commenter and others have been given notice of the proposed action and the basis of that action and an opportunity to be heard and to present relevant materials. The commenter has failed to present any legal basis for the claim of entitlement to procedures that have not been provided. The record of this rulemaking will be available for judicial review under procedures and standards prescribed for such action. To the extent that the commenter contends that due process requires that companies be given an opportunity to relitigate the regulations' formulaic definition of 'excessive,' the Commissioner rejects this comment. The constitutionality of this procedure has been clear at least since the decision in *20th Century v. Garamendi* (1994) 8 Cal.4th 216, 312.)

Summary of Comment (page 7):

The Commissioner has not looked at financial data provided by the industry as a whole or its various constituents. The Commissioner shot from the hip and made the excessiveness finding.

Response to Comment:

The Commissioner rejects this comment. The Commissioner has considered all of the information proffered by the industry in this rulemaking proceeding. The commenter confuses failure to consider claims with consideration and rejection of those claims.

Summary of Comment (page 7):

Insurance Code Section 12401.3(a) provides a two-part test for determining the excessiveness of a particular rate. This section provides that "[n]o rate shall be held excessive unless: (1) the rate is unreasonably high for the insurance or other services provided, and (2) a reasonable degree of competition does not exist in the particular phase of the business of title insurance to which the rate is applicable."

Response to Comment:

This comment is the same as that offered by Fidelity in its earlier comments, to which the Commissioner has responded in this file. The Commissioner incorporates here that response. No further response is required.

Summary of Comment (page 7):

The Legislature has also established a mandatory and exclusive procedure by which the CDI may challenge a rate charged by a title insurer on the grounds of excessiveness. That procedure is outlined in Sections 12414.13 though 12414.19 of the Insurance Code.

Response to Comment:

This comment is the same as that offered by Fidelity in its earlier comments, to which the Commissioner has responded in this file. The Commissioner incorporates here that response. No further response is required.

Summary of Comment (pages 7-8):

The Legislature, through Insurance Code Section 12414.29, stated that the enforcement of the rate-related provisions must be accomplished in accordance with the procedures set forth in Sections 12414.13 through 12414.19.

Response to Comment:

This comment is the same as that offered by Fidelity in its earlier comments, to which the Commissioner has responded in this file. The Commissioner incorporates here that response. No further response is required.

Summary of Comment (pages 8-9):

The Insurance Code establishes an exclusive procedure for determining a rate to be excessive as set forth in Section 12414.13. Under this procedure, a "person aggrieved" by a rate charged or a rating system established or employed by a title insurer may request that the title insurer review the subject rate or rating system. Insurance Code Section 12414.13. If the title insurer denies the request or fails to respond to the request within 30 days, the aggrieved party may file a written complaint and hearing request with the Commissioner. Insurance Code Section 12414.13. If the Commissioner finds that the complaint alleges an actual violation and the complainant would be aggrieved if the violation were proven, he is required to conduct a limited examination of the facts underlying the complaint. Insurance Code Section 12414.13. The Commissioner may also call an examination on his own initiative. Insurance Code Section 12414.21. If the Commissioner believes a rate is excessive, he may commence the examination process without waiting for a policyholder to file a complaint.

In this case, the Commissioner did not follow this procedure; he instead chose to make an excessiveness finding through a secret, back room, process.

Response to Comment:

This comment is the same as that offered by Fidelity in its earlier comments, to which the Commissioner has responded in this file. The Commissioner incorporates here that response. No further response is required.

Summary of Comment (pages 8-9):

If, after completion of the examination, the Commissioner has good cause to believe the title insurer is not in compliance with the rating laws, but that failure to comply is not willful, the Commissioner must issue a Notice of Noncompliance. Insurance Code

Section 12414.14. The Notice of Noncompliance must give the title insurer not less than 10 days or more than thirty days to correct the noncompliance. Insurance Code Section 12414.14. If, after the completion of the examination, the Commissioner has good cause to believe the title insurer is not in compliance with the rating laws and that the failure to comply is willful, or the title insurer fails to correct the alleged noncompliance within the time specified, the Commissioner may conduct a public hearing. Insurance Code Section 12414.15.

If, after the public hearing, the Commissioner finds the title insurer's rate, rating plan or rating system violates the rating laws, he may order the insurer to correct the violation within a reasonable time. Insurance Code Section 12414.16(a). If, after the hearing, the Commissioner finds the violation was willful, he may suspend or revoke the title insurer's certificate of authority, in whole or in part. Insurance Code Section 12414.16(b).

The proceedings that take place as a result of an insurer's failure to correct a noncompliance under these provisions are conducted in accordance with Chapter 5, commencing with Section 11500 of the Government Code. Insurance Code Section 12414.18

These provisions of the Government Code provide the respondent title insurer with procedural rights and safeguards, including notice of the proceedings, opportunity to review and respond to the "accusation" of the CDI, discovery (including, under certain circumstances, depositions and the right to compel discovery that has been refused) and the right to appear, call and cross-examine witnesses at hearing before an impartial administrative law judge. The Commissioner has the burden of both pleading and proof with respect to any claim that a title insurer's rates are excessive.

Response to Comment:

This comment is the same as that offered by Fidelity in its earlier comments, to which the Commissioner has responded in this file. The Commissioner incorporates here that response. No further response is required.

Summary of Comment (page 9):

Thereafter, the affected company is afforded a right of appeal and independent judicial review. Insurance Code Section 12414.19.

Response to Comment:

This comment is the same as that offered by Fidelity in its earlier comments, to which the Commissioner has responded in this file. The Commissioner incorporates here that response. No further response is required.

Summary of Comment (page 9):

In spite of the above-cited, the Commissioner has made a secret finding of the existence of both the elements of excessiveness (that a reasonable degree of competition does not exist and that rates are unreasonably high) without conducting an evidentiary proceeding, without notice to affected parties that he was in the process of making those findings and without affording affected companies due process.

Response to Comment:

This comment is the same as that offered by Fidelity in its earlier comments, to which the Commissioner has responded in this file. The Commissioner incorporates here that response. No further response is required.

Summary of Comment (page 10):

The doctrines of "prior resort to" and "failure to exhaust" administrative remedies are generally enforced against private parties. Here, however, the Commissioner has failed to resort to or exhaust the statutorily prescribed administrative remedy for attacking a title insurance rate on grounds of excessiveness.

Response to Comment:

The Commissioner rejects this comment. The "exhaustion" doctrine is legally and logically incapable of being cited against an agency in the course of its administrative process, if for no other reason because the existence of the administrative process refutes the claimed failure to employ that process.

Summary of Comment (page 10):

The Commissioner has attempted to craft the Amended Proposed Regulations in a way that could potentially deprive affected parties of a right to appeal his brazen sidestepping of the law. Under the Proposed Regulations, any rate in excess of the formulaic maximum is conclusively presumed to be excessive. Proposed Regulation Section 2359.6. The Proposed Regulations also provide that in a hearing on insurer's rates or charges, relitigation of a matter already determined by these regulations is out of order and shall not be permitted. Proposed Regulation Section 2359.6(c).

The Amended Proposed Regulations begin with: 1) a finding that there is an inadequate level of competition in the industry, and 2) the excessiveness finding (a section that proscribes relitigation of both the two elements of excessiveness – whether the rate is unreasonably high and reasonable competition exists in the industry) even though neither of these elements has been the subject of litigation.

Response to Comment:

The Commissioner rejects this comment. Regulation by formula based on industry-average costs has long been practiced by regulatory agencies and approved by the courts. That includes applying numerical values adopted in regulations to individual companies' hearings without giving those companies the opportunity to adjudicate the values. See, e.g., *20th Century Ins. Co. v. Garamendi* (1994) 8 Cal.4th 216.

Moreover, the commenter incorrectly assumes there will be no hearing on a rate that exceeds the interim maximum. A company that fails to bring its rate down to the required level would receive a notice of noncompliance and, if it requested a hearing, would receive one. To the extent that the commenter contends that due process requires that companies be given an opportunity to relitigate the Commissioner's formulaic regulatory definition of "excessive," the Commissioner rejects this comment. The effect of the "relitigation bar" is simply to assure that, in determining whether an individual insurer's rates are excessive, the administrative law judge does not entertain the question whether the premises underlying the rate regulations are sound. (See *20th Century v. Garamendi* (1994) 8 Cal.4th 216, 312.) This provision is appropriate and does not deprive companies of due process.

To the extent that this comment suggests that the finding of no competition must be made through the adjudicative process, the comment is rejected. The finding of no competition is distinct from the finding of excessiveness. (For example, two companies may be operating in the same market, so the competitive conditions will be the same, but only one of them may be charging excessive rates.) Nothing in the Insurance Code requires that the finding of market-condition be made in an adjudicatory hearing, and the commenter has cited no authority to that effect. The finding of the absence of competition is inherently better suited to rulemaking than to adjudication, since the finding is industry-wide and adjudication would be wasteful and could lead to inconsistent findings.

Summary of Comment (page 10):

The Amended Proposed Regulations prevent a company from legally challenging the issue of excessiveness, as well as any issue other than whether its rates exceed the maximum rates established pursuant to the Proposed Regulations. This is an attempt by the Commissioner to amend the Insurance Code and deprive companies of due process.

Response to Comment:

The Commissioner rejects this comment for the reasons stated above and because this comment does not regard the changes noticed on November 27, 2006, so no response is required. (Gov. Code section 11346.8(c).)

Summary of Comment (pages 10-12):

State agencies must follow statutorily mandated administrative procedures. *Agnew v. State Bd. Of Equalization*, 21 Cal.4th 310, 321 (1999). Moreover, the Proposed

Regulations may be challenged based on *California Assn of Nursing Homes v. Williams,* 4 Cal.App.3d 800, 811 (1970) in which the court stuck down regulations promulgated by the Administrator of the California Health and Welfare agency due to the agency's failure to adhere to the statutorily prescribed rulemaking process, to conduct hearings where the parties-in-interest could rebut evidence relied upon by the agency, to afford those parties an opportunity to be heard and offer evidence of their own, and to create a record that could be examined by a reviewing court. (no page citation provided.)

The Commissioner, like the agency in *Williams,* made a conclusive finding that the cost levels set by the Department of Finance (referred to by the regulations) met the "reasonable cost" standard. The court in *Williams* was critical of the fact that the finding was made on the basis of no evidence and held that only evidence which the opposite party has an opportunity to refute at the hearing may be relied upon as the basis of a finding." *Id*. at 811. In this case, as in *Williams*, parties in interest did not know the issue of excessiveness was being considered and decided. They had no opportunity to present and refute evidence on that issue. They were not notified of the "proceeding" or invited to participate.

The Commissioner made his findings of the absence of competition and excessiveness of rates in the "inner chambers" of the CDI. The affected companies had no opportunity to refute evidence relied upon and have had no access to a record upon which appeal may be based.

Response to Comment:

This comment does not regard the changes noticed on November 27, 2006, so no response is required. (Gov. Code section 11346.8(c).)

Summary of Comment (page 12):

The excessiveness finding was made for the title industry at large without taking into account specific financial data concerning individual affected members, in violation of the Insurance Code. The Commissioner or the appropriate trier of fact must carefully consider the rate factors, rating plans, claims and loss history, loss trends, expense structure, cost of capital, and profits of each industry participant on an individualizes and unique basis.

Response to Comment:

This comment is the same as that offered by Fidelity in its earlier comments, to which the Commissioner has responded in this file. The Commissioner incorporates here that response. No further response is required.

Summary of Comment (pages 12-13):

Under Insurance Code Section 12401.3(b) requires the trier of fact to consider, *inter alia,* "to past and prospective loss experience within and outside [California], a reasonable margin for profit and contingencies . . .[and] past and prospective expenses both countrywide and . . . specifically applicable to this state."

Insurance Code Section 12401.3 emphasizes the unique nature of each affected company and the need for an individualized analysis; it acknowledges that the systems of expense provisions included in the rates for title insurers, underwritten title companies and escrow companies may differ from those of others. This section also suggests that attention should be given to, amongst other factors, the size of the transaction and its effect upon the continuing solvency of the person or entity using the rate if a loss should occur, expense elements, including the management time that would ordinarily be expended in a typical transaction of a particular size . . .[and] the individual experience of the person or entity using the rate in question."

Response to Comment:

This comment, which is essential identical to Fidelity's earlier comment, to which the Commissioner has responded in this file, does not regard the changes noticed on November 27, 2006, so no response is required. (Gov. Code section 11346.8(c).)

Summary of Comment (pages 13-14):

As explained by Mr. Miller in his August 30, 2006 comments to the Proposed Regulations, from an actuarial standpoint, the Insurance Code must be read to require that a determination of "excessiveness" be based on company-specific information. The Insurance Code requires rates be set with a view to, and analysis of, the individual financial circumstances of the particular insurer: its unique rate factors. Rating plans, claims and loss history, loss trends, expense structure, cost of capital and profits.

The Commissioner's determination that rates are excessive on an industry-wide basis and establishment of an across-the-board maximum permissible rate without regard to the unique loss experience and financial circumstances of the affected insurer is statutorily impermissible.

Response to Comment:

This comment does not regard the changes noticed on November 27, 2006, so no response is required. (Gov. Code section 11346.8(c).)

Summary of Comment (pages 14-15):

The comments of counsel for the CDI at the hearing on the Proposed Regulations and the citation of the Washington Report in the Notice suggest the Amended Proposed Regulations have been promulgated to make it more difficult for dishonest members of the title industry to engage in certain corrupt practices, specifically, the payment of unlawful rebates and other incentives. The Commissioner apparently believes that such practices are widespread in the title industry and that, by limiting revenues, he will make it more difficult for corrupt companies to make such payments. He is, under the pretense of regulating excessive rates, seeking to eliminate corrupt practices.

This is wrong for at least two reasons:

1) It is intellectually dishonest. The Commissioner is basing his findings of non-competition and rate excessiveness upon the unproven perception that the title industry is rife with corruption. He is manipulating predicate facts to justify a perceived need to impose rate regulation. As discussed in Fidelity's Initial Comments and herein, these findings cannot be made by fiat, and must be made after full and procedurally proper evidentiary hearings.

2) The Commissioner may not punish all members of the title insurance industry for the behavior of a few bad actors. There are statutes that prohibit and punish the conduct the Commissioner is seeking to eliminate. The Commissioner must enforce these statutes rather than subject non-corrupt companies to unlawful and potentially ruinous rate regulation.

Response to Comment:

The Commissioner rejects this comment. The commenter has proffered no evidence to support the claim that there is less corruption in the title industry than the commenter asserts the Commissioner believes exists. Likewise, the commenter has proffered no evidence of manipulation of any facts. The commenter's procedural objections are legally unsupported and erroneous. The proposed regulations are not penal measures but rather are prospective consumer-protection measures contemplated by the applicable statutes.

Summary of Comment (page 15):

The Amended Proposed Regulations do not meet the approval standards enunciated in the Administrative Procedures Act. The APA establishes six standards a proposed regulation must meet if it is to become law: 1) necessity; 2) authority; 3) clarity; 4) consistency; 5) reference; and 6) non-duplication. If a proposed regulation fails to meet any of these standards, it cannot stand.

While the Commissioner has clarified a few of the definitions and data requests and fixed a number of improper references and cross-references, he has ignored or compounded the most fundamental deficiencies.

Response to Comment:

This comment does not regard the changes noticed on November 27, 2006, so no response is required. (Gov. Code section 11346.8(c).) Furthermore, this comment substantially restates the comments submitted by the commenter earlier, to which the Commissioner has responded and to which no further response is required.

Summary of Comment (page 15):

Authority: the Commissioner has no authority to set maximum rates by formula or otherwise. In the Amended Proposed Regulations, the Commissioner has replaced the fixed-percentage interim rollbacks with a formula for determination of the amount of such rollbacks. Neither of these approaches is permissible. The Insurance Code expressly prohibits the Commissioner from setting title insurance rates. Insurance Code Section 12401.

Response to Comment:

This comment does not regard the changes noticed on November 27, 2006, so no response is required. (Gov. Code section 11346.8(c).) Furthermore, this comment substantially restates the comments submitted by the commenter earlier, to which the Commissioner has responded and to which no further response is required.

Summary of Comment (pages 15-16):

Authority: the proposed statistical plan exceeds the Commissioner's authority. The Insurance Code authorizes the Commissioner to issue a "statistical plan" for the industry, however, the financial data he may lawfully collect is limited to information concerning aggregate economic performance and loss experience only. The Commissioner may not require the company to provide detailed information regarding every title transaction conducted in the State.

The reporting requirements in the Amended Proposed Regulations have been relaxed but continue to significantly exceed the authority of the Commissioner. The Commissioner has not eliminated the bulk of the irrelevant, impracticable, duplicative and highly expensive reporting requirements identified in Fidelity's initial comments (such as the identity of the entity performing escrow services if it is not the reporting entity, and detailed information regarding each title, escrow or other transaction that was opened, closed, or cancelled during the previous year.)

Response to Comment:

This comment does not regard the changes noticed on November 27, 2006, so no response is required. (Gov. Code section 11346.8(c).) Furthermore, this comment substantially restates the comments submitted by the commenter earlier, to which the Commissioner has responded and to which no further response is required.

Summary of Comment (page 16):

Authority: the modifications improperly and discriminatorily establish different implementation dates for different companies. Section 2356.4 of the Amended Proposed Regulations allows UTCs and CECs that had less than $10 million in revenues in the preceding calendar year (2007) and that are not affiliated with a title insurer to apply for a one-year extension of the reporting requirements which would take effect in 2009. The Commissioner does not explain why he proposes to favor smaller companies. Moreover, the Amended Proposed Regulations articulate no standards or criteria to be applied by the CDI in ruling upon applications under this section.

<u>Response to Comment</u>:

This comment does not regard the changes noticed on November 27, 2006, so no response is required. (Gov. Code section 11346.8(c).) Furthermore, this comment substantially restates the comments submitted by the commenter earlier, to which the Commissioner has responded and to which no further response is required.

<u>Summary of Comment (page 16)</u>:

Necessity: the Amended Proposed Regulations continue to require the submission of data that is unnecessary to a review of title insurance rates. The Amended Proposed Regulations continue to require the submission of mass data that is irrelevant and unnecessary to an evaluation of title insurance rates. Moreover, this flaw is compounded by the addition of new substantial reporting requirements that are also irrelevant and unnecessary. Title insurers and UTCs must now indicate whether "the affiliate in [the] transaction received a benefit from a lending institution where the benefit was derived from the lending institution's forbearance from charging a fee in connection with providing a normal banking function." This information is unnecessary and irrelevant to a determination regarding the appropriateness of title insurance rates. Moreover, relationships between industry constituents and financiers are regulated in Insurance Code Section 12413.5 and other state and federal laws.

<u>Response to Comment</u>:

The Commissioner rejects this comment. There can be no doubt that requiring a title company to reveal whether its affiliate received a benefit from a lending institute that was a party to the transaction is relevant to whether the referral fully complies with the law and whether the full cost of the insurance or service has been revealed. The commenter has failed to identify any state or federal statute that restricts the Insurance Commissioner from obtaining this information.

<u>Summary of Comment (page 17)</u>:

Necessity: the Commissioner claims he has relied upon several reports that were uncited at the time the Proposed Regulations were promulgated.

Three of these reports were available but not cited at the time the Initial Statement of Reasons (ISOR) was issued. The ISOR sent by CDI and dated July 3, 2006 (Exhibit B) identifies one report. The Notice issued on November 27, 2006 incorrectly states that the ISOR identified two reports, the Birnbaum Report and the July Report. Although no notice of modification to the ISOR was provided, the ISOR on the website posted on July 6, 2006 and dated July 3, 2006 includes a reference to the July Report.

How, when, why and at whose instruction was the ISOR amended and why was it amended without notice to the parties-in-interest?

Six additional reports are cited in support of the Amended Proposed Regulations. The Swiss Re Report and the Profitability Report pre-date the ISOR and could have been included as "studies relied upon" in the ISOR.

Response to Comment:

The Commissioner rejects this comment. To the extent that the Commissioner has placed additional documents in the file, they are either documents that were not previously available or documents that respond to comments from the public regarding the original proposal. Members of the public have been given a full opportunity to comment on those reports. The procedure fully complies with the applicable statutes.

Summary of Comment (page 17):

Necessity: the additional reports contain significant flaws which prevent them from providing a reasonable basis for the necessity of the Amended Proposed Regulations.

Fidelity and its experts have had only 18 days within which to review and critique the additional reports. This short time has revealed incorrect assumptions, incorrect analyses, and other flaws that prevent these reports from providing a reasonable basis for the necessity of the Amended Proposed Regulations. Fidelity and its experts expressly reserve the right to amplify and supplement the comments made regarding the additional reports.

Response to Comment:

The Commissioner rejects this comment. Members of the public have been given a full opportunity to comment on those reports. The procedure fully complies with the applicable statutes.

Summary of Comment (pages 17-18):

Necessity: the Profitability Report does not accurately measure the historical profits of title insurers. The Profitability Report purports to determine the profitability of the title insurers doing business in California over a five-year period. As noted by Mr. Miller in the appended report, five years is an insufficient time period for measuring profitability in the title industry because it cannot reasonably be expected to capture a full real estate cycle in which there are both "boom" and "bust" years. In fact, the Profitability Report draws only on data from 2001 through 2005, which were largely "boom" years in the real estate cycle; no "bust" years are represented at all. This limited review of profitability does not provide a reasonable basis for determining title industry profitability.

Mr. Miller also notes that the Profitability Report reveals a wide variation in profits and premium-to-surplus ratios among the 21 title insurers licensed in California. Under the California Insurance Code, these company-by-company variations should be reflected in the individual insurers' respective rates, not averaged to create an industry rate as required by the Amended Proposed Regulations.

Response to Comment:

The Commissioner rejects this comment. The Commissioner has responded elsewhere in this file to the cited comments of Mr. Miller.

Summary of Comment (page 18):

Necessity: rather than explain the methodology used to establish the "maximum rate of return," the Profit Factor Report reveals that it is: 1) based upon an incomplete methodology; and 2) fails to provide title insurers a fair and reasonable rate of return, thereby resulting in an impermissible taking in violation of the California and U.S. Constitutions.

In determining the "maximum rate of return," the CDI relies solely upon a risk premium methodology. As explained by Dr. Appel in his appended report, reliance upon a single model to estimate the cost of capital typically produces volatile and less reliable results than reliance upon a variety of models. Dr. Appel used two methods for estimating cost of capital: 1) the risk premium method; and 2) the discounted cash flow method. Discounted cash flow is the leading model used by economists to estimate the required rate of return in regulatory rate proceedings; however, CDI has ignored this method.

Utilizing both the risk premium method and the discounted cash flow method for computing cost of capital, Dr. Appel states that investors currently require a return on equity of at least 16.1% for bearing the risk of underwriting title insurance. In contrast, the maximum rate of return calculated in accordance with the Amended Proposed Regulations results in a rate of return of 11%. Accordingly, the maximum rate of return proposed by CDI does not provide a fair and reasonable rate of return as required by law.

Response to Comment:

The Commissioner rejects this comment. The Commissioner has responded to the comments of Dr. Appel elsewhere in this file.

Summary of Comment (page 19):

Necessity: the Swiss Re Report. CDI explains that it relied on the Swiss Re Report for the purpose of selecting a risk premium in defining its maximum rate of return in the Amended Proposed Regulations. The CDI has misinterpreted the Swiss Re Report in a material fashion.

As stated by Dr. Appel, the authors of the Swiss Re Report determined risk premiums for property casualty companies as applied to the market value of equity, not the book value as contemplated by CDI in its Amended Proposed Regulations. Because the market value of title insurers substantially exceeds their book value, the cost of capital must be adjusted by the ratio of market to book value and then multiplied by book value in order to determine an appropriate risk premium for purposes of ratemaking.

Based upon his sample of 100 companies (every publicly traded property casualty insurer in the United States), the current ratio of market to book value is 1.44. Thus, the cost of capital must be adjusted by a factor of 44% to yield a value that could be used in a ratemaking formula. Putting this value in context: assume (as CDI does) that current risk free interest rates were 5% and the CDI proposed risk premium of 6% were used to determine a cost of capital of 11%. If this value is to be used to determine the profit required by investors, it must be multiplied by the market value of equity. Because market value exceeds GAAP equity by 44%, an equivalent profit would be developed by using a cost of capital of approximately 16% (i.e. 11% * 1.44 = 15.84%). This shows that the maximum rate of return proposed by CDI which currently equates to 11% is inadequate for providing a fair and reasonable rate of return.

Response to Comment:

The Commissioner rejects this comment. The commenter has not explained how this comment is believed to be relevant to the proposed regulations. The proposed regulations are based on book returns, not market returns. Individual companies' market values may be higher or lower than their book values, as the commenter notes, but rate regulation in numerous industries has long and justifiably been based on book returns.

Summary of Comment (pages 19-20):

Necessity: the Sales Cost Factor Report incorrectly assumes that: 1) sales costs should be uniform throughout the industry; 2) an appropriate level of sales costs is that which would be charged in a reasonably competitive market; 3) the title insurance market is not reasonably competitive; and 4) "reverse competition" is undesirable and results in increased sales costs. Based on these incorrect assumptions, the Sales Cost Factor Report calculates a "reasonable" sales cost factor for the industry. Because these calculations are based on incorrect assumptions, the results are flawed.

Response to Comment:

Each of these comments is addressed below.

<u>Summary of Comment (pages 19-20)</u>:

In setting a sales cost factor to be applied to the industry within this report, the CDI assumes it is appropriate to set uniform cost limits on an industry-wide basis. As noted by Mr. Miller, this assumption is incorrect. The Insurance Code requires determination of a title insurer's rates, and the components thereof, on an insurer-specific basis taking into account each insurer's unique operating methods.

<u>Response to Comment</u>:

The Commissioner rejects this comment. The proposed regulations do not set any cost limits – uniform or other. The proposed regulations set a maximum rate, which takes into account various cost components, which in turn are based on industry-average results. Nothing in the proposed regulations prescribes how much a company may spend on any cost component.

<u>Summary of Comment (pages 20-21)</u>:

CDI asserts, without support, that reverse competition exists in the industry and that because reverse competition increases sales costs above a level that is reasonable, actual industry sales costs may not be used to calculate the sales cost factor. Dr. Vistnes states in his appended report that this assertion is flawed in its assumption that reverse competition is undesirable and in its conclusion that the reverse competition increases sales costs.

Based on this flawed assumption regarding industry sales costs, CDI looks to estimates of sales costs in other personal lines insurance markets, which CDI assumes to be "reasonably competitive" to determine the sales cost factor to be used in the Amended Proposed Regulations. As Dr. Vistnes notes, the CDI suggests the appropriate level of sales expenditures in California's title insurance industry can be estimated by looking at sales expenditures in other reasonably competitive markets. This assumption that what is an appropriate level of sales expenditures in one reasonably competitive market is appropriate for all markets is wrong and at odds with empirical evidence.

The assumption that other personal lines are comparable to title insurance for purposed of estimating appropriate sales costs is flawed because, as Mr. Folk notes in his appended report, it fails to take into account the fact that, unlike homeowners and private passenger automobile insurance, for which expected commissions on renewal premiums account for some of the agent's compensation, title insurance is a single premium product that does not generate renewal income for the insurer or the agent. The commission on these products is the initial commission plus (at a minimum) 1.5 to 1.75 times the initial commission value, which reflects the value of the renewal commissions on the market. With an average commission for homeowners and private passenger auto of 17.3%, a true market measure of a comparable single premium commission would be 43% -47%, not the 15% proposed by the Commissioner.

Response to Comment:

The Commissioner rejects this comment. The Commissioner has responded to the comments of Mr. Folk and Dr. Vistnes separately in this file.

Summary of Comment (page 21):

Necessity: the July Report and the Interim Rate Report (collectively, the "Rollback Reports" which purport to justify and explain the reasoning behind the interim rate reductions are so flawed that they do neither.

The calculations in these reports have no connection to generally accepted actuarial ratemaking procedures. Miller at p.5. Moreover, the Rollback Reports appear to have drawn on national, rather than California, data which is inappropriate for consideration of California rates. *Id.* Finally, the Interim Rate Report incorrectly assumes all insurers were charging uniformly excessive rates in 2006. This assumption is at odds with the Insurance Code and generally accepted actuarial principles. *Id.*

Response to Comment:

The Commissioner rejects this comment. The Commissioner has responded to the cited comments of Mr. Miller separately in this file.

Summary of Comment (pages 21-22):

Necessity: the reliability of the calculations in the Rollback Reports is questionable. For example, in the discussion of Table 3("Calculation of Interim Rate Reduction for Title Purchase Transactions"), the Interim Rate Report states that the values used for 2000 and 2006 Average Title Purchase Premium (a factor necessary to the calculation) were "based on actual real estate transaction . . . . as provided by DataQuick after eliminating any transactions reported with a zero dollar ($0) transaction size." Although the Interim Rate Report offers three explanations for the elimination of the zero dollar transaction size data points, those explanations are contradictory and call into question the reliability of both the data provided by DataQuick and its use in the Interim Rate Report. Folk at p.3.

The Rollback Reports contain clear mathematical errors. The July Report states that a 25% increase in the sales price of a $250,000 house results in a sales price of $300,000. This is incorrect; a 25% increase on $250,000 is $312,500.

Response to Comment:

The Commissioner rejects this comment. The calculations employed in quantifying the effect of the increase in housing prices in the proposed regulation are standard statistical and actuarial methods wholly appropriate here. The cited mathematical error regarding the 25% increase solely affects the example given in the text and has no effect on the proposed regulations.

Summary of Comment (page 22):

Necessity: the Washington Report addresses practices in the Seattle, Washington area only, which has a different market structure, applicable law and regulatory scheme than California. The Washington Report is, therefore, irrelevant to a determination whether title rate regulation in California is necessary or appropriate. Moreover, the Washington Insurance Commissioner did not take any disciplinary action against the industry in response to the findings. Instead, he announced increased enforcement efforts on a going-forward basis and published clarifications with respect to the particular Washington law at issue. The Washington Report provides no support for the Amended Proposed Regulations.

Response to Comment:

The Commissioner rejects this comment. The Commissioner has cited this report merely to show that the problems of reverse competition exist beyond the borders of California and appear to be endemic to the business of title insurance.

Summary of Comment (page 22):

Clarity: The Insurance Code requires the regulations be drafted in plain, straightforward language, avoiding technical terms and, where possible, using coherent and easily readable language so the meaning of the regulations will be readily understood by the persons affected by them. As noted in Fidelity's initial comments, the Proposed Regulations are unduly prolix and poorly drafted, and contain so many ambiguities and errors that they are largely incomprehensible.

The modifications address some of the clarity issues, such as incorrect cross-references, but many clarity issues remain.

Response to Comment:

This comment is discussed in detail below.

Summary of Comment (page 22):

Clarity: New undefined term. Section 2358.9 reads: "[e]xcept as provided in subdivision (e) of this section, commencing on October 1, 2007, no company may use any rate that produces charges for any escrow service that exceed the interim maximum rate for escrow (InterimMaxEscrowRate)." Although the modifications add a definition for "title insurance company," the term "company" is not defined in the Amended Proposed Regulations, making the scope of this provision unclear.

<u>Response to Comment</u>:

The Commissioner rejects this comment. The word "company" is well understood.

<u>Summary of Comment (page 22)</u>:

Clarity: <u>Full escrow</u>: the definition of "full escrow" in Section 2358.7(l) has been amended to insert "at a minimum" before the list of activities. While this insertion conforms to the formal definition to the informal definition included in the instructions for report T101.D, the change does not address other clarity issues, including: 1) its reliance on the undefined term "typical escrow transaction"; 2) its inconsistency with definitions in Insurance Code; 3) its conflict with industry usage; and 4) the gap left between definitions of "full escrow" and "subescrow" under the Proposed Regulations. These issues were discussed in depth in Fidelity's initial comments.

<u>Response to Comment</u>:

This comment does not regard the changes noticed on November 27, 2006, so no response is required. (Gov. Code section 11346.8(c).)

<u>Summary of Comment (page 23)</u>:

Clarity: <u>Average Title Class Relativity:</u> The modifications correct mis-references to existing data elements and insert certain data elements that were missing but necessary to the calculation of the average title policy class relativity. These corrections fix certain errors, but they do not address the fundamental mathematical flaws discussed in Fidelity's initial comments. The modifications also do not resolve the ambiguities inherent in the fact that "average title policy class relativity" is defined by reference to each company's "base policy," but no definition or description of "base policy" is provided in the Amended Proposed Regulations. This term arises repeatedly in equations used to calculate the maximum charge for a title insurance policy, accordingly, the absence of a definition introduces an ambiguity that renders the resulting maximum charge meaningless.

<u>Response to Comment</u>:

This comment does not regard the changes noticed on November 27, 2006, so no response is required. (Gov. Code section 11346.8(c).)

<u>Summary of Comment (page 23)</u>:

Clarity: <u>Data Request T103.</u> Report T103.04 has been amended by the substitutions of "paid" for "incurred" in the following sentence: "[r]eport the entire escrow fee and do not deduct any amounts incurred for work charges/fee splits or add any amounts received for work charges/fee splits." This resolves some ambiguity in the request, but does not address the ambiguity inherent in the language "fees only for transactions in which the reporting company was the initial recipient of funds from the ultimate consumer" also contained therein. It is unclear how an escrow fee is to be reported when the lender pays the fee (for example, in a "no closing cost" refinancing or another instance when funds are not received from the ultimate consumer.)

<u>Response to Comment</u>:

This comment does not regard the changes noticed on November 27, 2006, so no response is required. (Gov. Code section 11346.8(c).)

<u>Summary of Comment (page 23)</u>:

Clarity: <u>Interim Maximum Rates</u>. The changes to the interim maximum rate provisions are so substantial that they require the addition of new defined terms not included in the Proposed Regulations. A similar change was made to the provisions relating to interim maximum rates for escrow. See Amended Proposed Regulation Section 2358.9(a)(1). These changes have the effect of increasing the complexity and lack of clarity.

<u>Response to Comment</u>:

The Commissioner rejects this comment. The commenter has not identified the terms claimed to be unclear.

<u>Summary of Comment (page 23)</u>:

Clarity: <u>Interim Maximum Rates</u>. No method is provided for determining what 2000 rates should be used as a basis for comparison when a transaction involves a new product or coverage that was not available in 2000. Because rate structures change, title insurance products and title coverages have changes and will continue to change over time. It is impossible to compare rates applied to "the same policy" as prescribed in the Amended Proposed Regulations. To compare 2009 rates to 2000 rates is to compare apples to oranges.

<u>Response to Comment</u>:

The Commissioner rejects this comment. Companies are presumed to know what rates apply to transactions in order to conduct the business of title insurance.

<u>Summary of Comment (page 24)</u>:

Clarity: <u>Interim Maximum Rates</u>. The Amended Proposed Regulations establish values for TitleInterimReduction divided into three transaction categories – Title Purchase, Title Non-Purchase Refinance and Title Non-Purchase Other-than-Refinance – to be used as one of the factors for calculation of an Interim Title Insurance Rate for each and every rate. However, no explanation is provided for what these values are or how they were determined. Moreover, although the three transaction types are assigned widely different values, no explanation is given for the differences.

Response to Comment:

The Commissioner rejects these comments. The terms were taken from companies' rate filings and can reasonably be assumed to have been understood in the industry.

Summary of Comment (page 24):

Clarity: Interim Maximum Rates. The modifications relating to the interim maximum rates for escrow require different rate reductions in each of three regions. Those regions are defined as geographically proximate groups of counties: Bay Area, South, and Rest of State, but no rationale is provided for making such divisions or for the allocation of counties to each region. Moreover, no difference in maximum escrow rates based on "region" is provided in these provisions that set the ongoing "maximum charge for an escrow transaction." These regional distinctions are arbitrary and serve no apparent purpose.

Response to Comment:

The Commissioner rejects this comment. There is no lack of clarity because the regions are properly defined by county. The basis for the categorization is explained in the staff report.

Summary of Comment (page 24):

Clarity: Charge for interest-bearing account. The modifications change the maximum fee that a CEC may charge for placing an escrow deposit into an interest bearing account from a fixed $25 to a requirement that the fee be filed as a rate "for another service" in accordance with new filing procedures and requirements set forth in the Proposed Regulations. This change eliminates the arbitrary $25 fee cap in favor of a fee chosen by the company, but it does not address the ambiguity this provision creates because it applies only to CECs, while both title insurers and UTCs also establish such accounts. Moreover, by separately addressing this fee and the requirement that CECs make rate filings with respect to such fee, the Amended Proposed Regulations imply that this type of fee would not otherwise be subject to filing as a "rate" as defined in Section 12340.7 and subject to Section 12401.1 of the Insurance Code.

Response to Comment:

The Commissioner rejects this comment. To the extent that it opposes the November 27 amendment, it makes the unreasonable inference that the express requirement to file some rates represents an exemption from filing requirements for all other rates, which is neither logical nor statutorily permissible.

Summary of Comment (page 24):

Clarity: the modifications are not "clearly identified" as required in the APA. Although the Amended Proposed Regulations state that "text added by this notice is double-underlined; deletions to the proposed text in the prior notice are in ~~*strikethrough italics*~~," modifications to four tables included in the Amended Proposed Regulation (over 40 pages) are not so indicated. Instead, the entire table is first marked as deleted and then reinserted as new text even though only minor changes were made. This violates the requirement that "the full text of the . . . amendment . . . with the change clearly indicated," be made available to the public for comment."

Response to Comment:

The Commissioner rejects this comment. There is no ambiguity. The procedure fully conforms to the law.

Summary of Comment (page 25):

Clarity: Section 2358.9 is redlined as follows:

Section 2358.9 Interim maximum rates for escrow

(a) *(1) Except as provided in subdivision (e) of this section, c~~C~~ommencing on ~~March~~October 1, 200~~7~~9, no ~~title insurance~~ company may ~~charge~~use any rate ~~greater than 73 percent of the rate it was charging for the same service on November 1, 2000.~~that produces charges for any escrow service that exceed the interim maximum rate for escrow (InterimMaxEscrowRate), defined as the product of*

The redline suggests the original language of the Proposed Regulations read: "Commencing on March 1, 2007, no title insurance company may charge a rate greater than 73 percent of the rate it was charging for the same service on November 1, 2000." That is incorrect. Instead, the original language read "Commencing on March 1, 2007, no controlled escrow company may charge a rate greater than 73 percent of the rate it was charging for the same service on November 1, 2000." This misstatement is misleading because, as redlined, the amendment appears to have little effect on the scope of the provision. Neither "title insurance company" nor "company" was defined in the Proposed Regulations, but both may be broadly interpreted. The original text, however, referred to "controlled escrow company," a more limited category of companies. This amendment greatly increases the applicability of the escrow interim rate provisions. Because this provision misstates the original text and misrepresents the nature and impact of the revision, the revisions are not "clearly indicated" in the Amended Proposed Regulations.

Response to Comment:

The Commissioner rejects this comment. The commenter clearly understood the error in the stricken text, which was obvious and does not pertain to the amended proposed regulations.

Summary of Comment (Bates pages Dec.Comments 545-546):

These pages are a November 28, 2006 letter from LeBoeuf, Lamb, Greene & MacRae on behalf of Fidelity requesting a new 45-Day Notice and comment period and a hearing on the modifications on the grounds that the changes contained in the Amended Proposed Regulations are such that no reasonable member of the directly affected public could have determined from CDI's notices that the modifications could have resulted and the modifications were not otherwise addressed at the August 30, 2006 hearing. Gov't Code Section 11346.8(c).

Response to Comment:

The Commissioner rejects this comment. The commenter has failed to explain why the amendments, which affect only existing proposed sections and deal with the same topics as their original text, are not, in commenter's view, "sufficiently related to the original text that the public was adequately placed on notice that the change could result from the originally proposed regulatory action." (Gov. Code section 11246.8.)

Summary of Comment (Bates pages Dec.Comments 547-566):

Bates pages Dec.Comments 547-565 contain the Notice of Proposed Action and Initial Statement. Bates page Dec.Comments 566 is a blank page.

Response to Comment:

This portion of the comment is not a "comment" per se, but rather, is a reprint of portions of the rulemaking file, as prepared by the Department. No further response is necessary.

Summary of Comment (Bates pages Dec.Comments 676-703):
Bates pages 676-703 are the comments of David Appel, submitted on behalf of Fidelity National Title Group.

Summary (page 1-2): The commenter summarizes his background and qualifications.

Response: Because this is not a comment specifically directed at the proposed regulation text, no response is required.

Summary (page 2-3): The commenter summarizes his comments. The Staff Report relies solely on a risk premium method. The discounted cash flow method should also be considered. The return should be allowed on the market value of the companies, not the book value.

Response: The responses are below, in the more detailed summary of the comments.

Summary (page 3): The Staff Report relies on the single factor version of CAPM, with an assumed beta of 1.0, and a market risk premium of 6%. The Fama French three-factor version of CAPM should be used instead.

Response: The commenter has a long history of relying exclusively on the single factor version of CAPM. In fact, he relied on it in his previous testimony in this rulemaking. There is no direct evidence provided that any of the title insurers that are included in the commenter's calculation could be considered either small or distressed. The footnotes indicate that the betas are calculated based on monthly returns. Typically that means 60 months or five years. During this time the title insurance industry has experienced a windfall profit due to rapid real estate price appreciation. To use such a windfall as the basis for a projection going forward in a regulated environment is inappropriate.

Summary (page 3-5): More than one model should be used. The discounted cash flow (DCF) model should be the second model. Both models should get equal weight. The commenter shows calculations from the CAPM and DCF model supporting either a 16.1% or 14.7% return. The former uses the three-factor CAPM and the latter the single-factor. The regulations allow an 11% return.

Response: The commenter made substantially similar comments about the DCF model in his previous testimony in this rulemaking. See that previous testimony for the response as to why his version of the DCF model is inappropriate for an industry that has had a windfall profit since 2000. See the above response for the CAPM model.

Summary (page 5): The Staff Report uses the GAAP equity for the amount of capital upon which rates are based. The CAPM and DCF models use the market value of an investment. If the market based cost of capital is applied to an accounting measure of equity for ratemaking purposes, the estimate costs of capital must be adjusted to reflect the difference between market and book values of equity. The market value of equity substantially exceeds book value for insurers.

Response: See response to common comment T.21. The title industry has experienced a windfall profit since 2000 that has inflated the market values. To use these inflated market values as the basis for rate regulation going forward is clearly inappropriate.

Summary (page 5-6): Based on a sample of approximately 100 companies (every publicly traded property casualty insurer in the U.S. as reported in the Compustat database, the current ratio of market to book values is 1.44. For companies with more than 90% of revenues derived from property casualty insurance, the ratio is 1.78. Even using the lower ratio increases the 11% in the proposed regulations to 16%.

Response: See above response.

Summary (page 6): The commenter summarizes his comments.

Response: No further response is necessary as the comments are already responded to, above.

Summary (page 6 and attachments): The commenter provides a series of mathematical calculations.

Response: See above responses and responses to substantially similar calculations in this commenter's previous testimony in this rulemaking.

Summary of Comment (Bates pages Dec.Comments 589-598):
Bates pages Dec.Comments 589-598 are the comments of Mark Folk, submitted on behalf of Fidelity National Title Group.

Summary of Comment, Page 2: The commenter describes his qualifications and work experience.

Response: This portion of the comment is not specifically directed at the Commissioner's proposed regulations or to the procedures followed in proposing the regulations. No response is, therefore, necessary. (Gov. Code section 11346.9.)

Summary of Comment, Page 2: The commenter describes his comments as supplemental to those he submitted on August 30, 2006.

Response: This portion of the comment is not specifically directed at the Commissioner's proposed regulations or to the procedures followed in proposing the regulations. No response is, therefore, necessary. (Gov. Code section 11346.9.)

Summary of Comment, Page 2: Limiting sales cost factor to 15% ignores true cost of providing title insurance to consumers in CA and ignores market forces in their entirety. The Staff Report on the Sales Factor fails to account for fact that title insurance is single premium, therefore one would expect commissions to be higher, even if the level of effort required by an agent to generate the policy is the same. Therefore, the true commission for private passenger auto times 1.5 to 1.75 indicating a true market measure of commission value would be in the range of 43-47 percent. In credit insurance, California regulations limit commissions to 35% for credit life and 30 percent for disability coverages and the level of underwriting for these products is low.

Response: The Commissioner rejects this comment. The sales factor specifically considers the reasonable cost of providing title insurance to consumers in California and is created specifically to respond to the actual reverse competitive market forces in title insurance and escrow markets in California. The sales cost factor covers the reasonable costs of marketing and sales of title insurance and escrow, including personnel and non-personnel costs of sales, marketing and "customer" support, where "customer" refers to the referrers of title insurance business. In contrast, the commission earned by an independent agent for auto insurance covers other things in addition to sales and marketing, including underwriting and claims settlement, both of which are covered by other components in the proposed regulations. In addition, the reference to collecting premiums over the life of the policy is irrelevant because the comparison is what auto insurers spend on sales and marketing on average versus what title insurers spend on sales and marketing on average. As the staff report on the sales factor points out, auto insurers spend about 15% on commissions, which covers more than sales and marketing. Similarly, the value of an agent's book of business is not comparable to or relevant to determining the reasonable cost of sales and marketing expenses. The so-called "true market value" of agent commissions is inapplicable and irrelevant to the determination of reasonable sales and marketing expenses for auto insurance, let alone for title insurance and escrow. The commenter's comparison provides no insight into the reasonable costs of sales and marketing for either auto or title insurance. As stated above, the proper comparison is the industry cost of sales and marketing as a percentage of premium in title insurance to that cost for auto insurance. As explained in the staff report on the sales factor, that comparison justifies the 15% value selected by the Commissioner.

The commission levels for credit insurance cited by the commenter are maximum amounts, not the reasonable average amount for the credit insurance industry. In addition, the commission for credit insurance covers the underwriting and issuance of the policy as well as claims support and, consequently, is payment for more than sales and marketing activities. As with auto insurance, the proposed regulations do not limit what a title insurer can spend on sales and marketing expenses. The establishment of a reasonable value for sales and marketing as an input into an overall rate regulation formula is precisely analogous to the review of rates for auto insurance, which also inputs a reasonable value into an overall rate regulation formula.

Summary of Comment, Page 3-4: Interim Rate Reduction calculations are based on flawed and unreliable data. The Staff Report on the Interim Rate Reduction identifies problems with the DataQuick data that render the interim rate reduction calculations and values highly suspect. The use of the CAR forecast of median existing home prices for the 2009 calculation is without support. There is no evidence omitting the CAR median condo sales prices to somewhat offset the absence of new home sales prices will mitigate the data problems.

Response: The Commissioner rejects this comment. DataQuick is an industry standard source of information on real estate transactions and used by analysts and title insurance market participants, including the California Association of Realtors. No data set is perfect, but the Commissioner finds the DataQuick data reliable for the purposes used in the interim rate calculations. The fact that the November 27, 2006 Staff Report on the Interim Rate Reduction and the superseded July 3, 2006 Staff Report on the Interim Rate Reduction discuss issues with the use of the data does not undermine the reliability of the data, but serves to explain the Commissioner's use of the data.

Summary of Comment, Page 5: Appendix 2 does not provide the information described.

Response: The Commissioner rejects this comment. The November 27, 2006 Staff Report on the Interim Rate Reduction does provide the information described in Appendix 3. The reference to Appendix 2 in Staff Report is an obvious typographical error as the specified information is clearly provided in Appendix 3 of the Staff Report.

Summary of Comment, Page 5: The Amended Proposed Regulations ask for written premiums with no subsequent adjustment for the change during the year in the unearned premium reserve. Therefore, the premium numbers called for by the Amended Proposed Regulations violate Generally Accepted Accounting Principles ("GAP") [sic], the purported basis of the Amended Proposed Regulations.

Response: The Commissioner rejects this comment. Unlike most other lines of insurance, title premiums are fully earned upon policy issuance. Consequently, there is little or no unearned premium reserve and the absence of such a line item consequently does not distort the reported experience.

Summary of Comment, Page 5: Several reports fail to distinguish between cash and accrual accounting. Some instructions call for reporting of paid expenses which is a violation of GAAP accounting.

Response: The Commissioner agrees and disagrees with this comment. The primary instructions for the income statement reports are to report on a GAAP basis. It is, therefore, clear that all expense items are to be reported on the GAAP incurred basis. The occasional use of the term “paid” does not reasonably lead a reporting company to abandon the prime directive or introduce any lack of clarity. The Expense Exhibit of the Statutory Annual Statement is also based on accrual accounting, but the word “paid” appears in the line item “Amounts paid to or retained by title agents.” Yet, it is clear with the Statutory Annual Statement – as with the statistical plan income statement reports – that the use of the word “paid” does not override the direction to report experience on an accrual basis.

Summary of Comment, Page 5: The instructions for line TI03.27 state: "[t]his entry is the sum of lines TI03.23 through TI03.26." In fact, the entry needs to include T103.22 to properly record the amount for title loss and loss settlement expenses.

Response: The Commissioner agrees with this comment. The reference to TI03.23 has been changed to TI03.22. This is a non-material change as the intent was obvious to the commenter. In addition, the description does not affect the calculation because the report is submitted on a spreadsheet template provided by the Department of Insurance and this line item is a calculated cell that requires no entry by the reporting company.

Summary of Comment, Page 5: The instructions for line TI03.80 state: "[this entry is the sum of lines TI03.76 through T103.78 less line T103.79." Since line 1103.79 states per the instructions "report this entry as a negative amount for amounts incurred" the mathematical impact of these instructions taken together is to add rather than deduct investment expenses in arriving at "Net Investment Income" — a clear computational error.

Response: The Commissioner rejects this comment. The description does not affect the calculation because the report is submitted on a spreadsheet template provided by the Department of Insurance and this line item is a calculated cell that requires no entry by the reporting company and the intent of the calculation is clear.

Summary of Comment, Page 5 – 6: There is a lack of clarity regarding "Realized Capital Gains" and "Unrealized Capital Gains". The Amended Proposed Regulations fail to describe the appropriate amounts to record for these two items. Both of these items should be described as "Net Realized Capital Gains (Losses)" and "Net Unrealized Capital Gains (Losses)" and should net gains against losses.

Response: The Commissioner rejects this comment. The entries for capital gains are adequately described and provide the necessary guidance. The commenter's interpretation is unreasonable as it would violate GAAP reporting.

Summary of Comment, Page 6: T112.07 incorrectly indicates that TI03.27 includes an amount for title losses paid. As described above, T103.27 incorrectly excludes title losses paid.

Response: The Commissioner rejects this comment. The reference in TI12.07 to TI03.27 is correct.

Summary of Comment, Page 6: Lines TI12.09 through TI12.14 incorrectly refer to Lines T103.79 through TI12.85. The correct references should be Lines T112.80 through T112.86.

Response: The Commissioner rejects this comment. The commenter has not correctly described the references he claims are incorrect and he recommends references to items that do not exist. Lines TI12.09 through TI12.14 do not refer to Lines TI03.79 through TI12.85, but to Lines TI03.79 through TI03.85. There are no lines TI12.80 through TI12.86 in Table 12.

Summary of Comment, Page 6: The description for item TI07.I lacks clarity.

Response: The Commissioner rejects this comment. The comment addresses the relevance of the data item, not the clarity. The commenter clearly understands what is to be reported by the nature of his comment and, thus, indicates the clarity of the description.

Summary of Comment, Page 6: Analogous errors to those described above occur in UTC03, UTC 07 and UTC12.

Response: The Commissioner accepts this comment in part and rejects this comment in part. The responses to the references to UTC03, UTC07 and UTC12 are the same as the responses to comments on TI03, TI07 and TI12.

Summary of Comments, Page 6-7. There are errors in the formula to calculate the interim maximum title insurance rate.

Response: The Commissioner rejects this comment. The formula to calculate the interim rate reduction is sound and correct. The commenter's claims are riddled with inaccuracies. The commenter has mischaracterized the interim rate calculation formula and then criticized the mischaracterizations. The commenter is incorrect in his assertion that the Interim Rate Report calculates the interim rate reduction as a percentage of the current (2006) actual rates. The Interim Rate Report calculates the interim rate reduction based on a theoretical set of charges based on year-2006 transactions but using year-2000 rate tables. The commenter is incorrect in his assertion that that Table 3 of the Interim Rate Report sets the "InterimMaxTitleRate" for title insurance at $1,271.13. The table does no such thing. The value $1,271.13 appears in line 12 of the table as "Indicated Reasonable 2006 Premium." As is explained on Summary of Comment, Page 2 of the report, this is the reasonable title insurance charge in 2006 based on 2006 transaction values. The commenter calculates a range of possible values for the InterimMaxTitleRate for a transaction that would have cost $1068.85 in 2000. The calculated range is from $795.22 to $1,068.85. The commenter then claims that since the value $1,271.13 from Table 3 in the Interim Rate Report falls outside this range, the Interim Rate Report and the equation section 2357.19 contradict one another. Since the value from Table 3 represents the reasonable average year 2006 title insurance premium and not, as the commenter claims, a specific interim maximum title rate, the comparison is invalid.

Summary of Comment, Pages 8-10: The commenter offers his curriculum vitae.

Response: "This portion of the comment is not specifically directed at the Commissioner's proposed regulations or to the procedures followed in proposing the regulations. No response is, therefore, necessary. (Gov. Code section 11346.9.)

<u>Bates pages Dec.Comments 599-605 are the comments of Michael J. Miller, submitted on behalf of Fidelity National Title Group.</u>

Summary (page 1): The commenter summarizes his background and qualifications and the purpose of his testimony.

Response: Because this is not a comment specifically directed at the proposed regulation text, no response is required.

Summary (page 1-2): The regulations create a new definition of "excessive" which is significantly different from the statute. Section 12401.3 requires a determination that reasonable degree of competition does not exist and that the rates for a specific title insurer are unreasonably high in relation to its expected costs. That means whether an insurer's rates reasonably reflect its expected losses, expenses and cost of capital. Section 12401.3 specifically permits the expense provisions to reflect an insurer's unique operating methods. Section 12401.5(b) gives the authority to prescribe a statistical plan "reasonably adapted to each of the rating systems in use within the state", clearly indicating the permissibility of a variety of rating system. Section 12401.5(d) refers to the review of individual rate filings. The intent of the legislature was to provide for individual rate filings, with unique rating plans and reflecting each insurer's costs.

Response: The only change to the definition of excessive between the July 6 and November 27 notices is to extend it to apply to preliminary reports. Because these comments do not address the November 27 changes to the proposed regulations, no further response is necessary.

Summary (page 3): Five years of data is insufficient for making any reliable conclusions concerning the profitability of any entity within the title insurance industry. Because of the cyclicality of the real estate market, ten years is the minimum. The years 2001-2005 only reflects boom years, not good and bad years. The report shows wide divergence of profits for each year among the 21 title insurers and a wide divergence of premium-to-surplus ratios. These show different cost structures and different costs of capital that should be reflected in rates. The regulations will force a uniform rate structure.

Response: The competition report included data on profitability for a ten-year period from 1995-2004. Regulation by formula based on industry-average costs has long been practiced by regulatory agencies and approved by the courts. The proposed regulations do not "fix" or "determine" or "force" rate levels. They define the level above which the rate is excessive. Companies are free to compete by charging any rate they wish so long as the rate is not "excessive." (Ins. Code § 12401.3.) It has long been understood that the code authorizes the Commissioner to prohibit excessive rates and that doing so does not constitute the proscribed fixing or determination of rates.

Summary (page 3-4): The laws contemplate rates calculated for each title insurer based on each insurer's unique cost of capital. The proposed regulations completely rewrite the laws by making each insurer's capital structure, investment returns and cost of capital irrelevant.

Response: The Commissioner rejects this comment. Regulation by formula based on industry-average costs has long been practiced by regulatory agencies and approved by the courts. That includes applying numerical values adopted in regulations to individual companies' hearings without giving those companies the opportunity to adjudicate the values. See, e.g., 20th Century Ins. Co. v. Garamendi (1994) 8 Cal.4th 216.

Summary (page 4): The staff report establishes an arbitrary sales cost factor of 15%. This 15% is expense provision is not based on each insurer's unique operating methods as contemplated by current law.

Response: The Commissioner rejects this comment. Regulation by formula based on industry-average costs has long been practiced by regulatory agencies and approved by the courts. The 15% figure comes from the experience of insurers writing in markets not afflicted with reverse-competition. The high commission rates and other sales costs associated with title insurance are the effects of reverse-competition. There is nothing improper about denying companies the costs associated with reverse-competition.

Summary (page 4): The interim rate reduction calculations have no connection to generally accepted actuarial ratemaking procedures. No recognition was given to real estate cycles or indicated rates. The loss and expense trends, and the projected losses and expenses, appear to have been computed without California data. None of the data is specific to any title insurer or agent.

Response: The Commissioner rejects this comment. The proposed regulations have been amended so that the interim rate reduction is only a fallback if the stat plan is not in place by the specified date. If by 2009 sufficient data are not available to base rates on costs derived from the statistical plan, it is reasonable to implement the interim maximum rates to protect consumers from excessive rates while the statistical plan data are obtained. The rates in 2000 are those which the companies themselves chose to use. The rate reduction allows for increased claims and expenses in the year of the reduction, so profit levels will not be substantially affected. The loss trend is based on the change in transaction size, which is defined in 2357.19 in terms of the California Association of Realtors forecast. Expense trend is based on the countrywide consumer price index, which is a reasonable proxy for California. The split of non-variable expenses between losses and fixed expenses are projections based on long-term observed averages. Regulation by formula based on industry-average costs has long been practiced by regulatory agencies and approved by the courts.

Summary (page 4-5): The fundamental assumption of the interim rate reduction, that all title insurers and agents were charging rates in 2006 that were uniformly excessive, is absolutely incorrect and beyond belief. Profit or loss varies significantly. Current laws entitle each insurer the opportunity to show that its rates are not excessive, inadequate or unfairly discriminatory.

Response: The Commissioner rejects this comment. The proposed regulations have been amended so that the interim rate reduction is only a fallback if the stat plan is not in place by the specified date. If by 2009 sufficient data are not available to base rates on costs derived from the statistical plan, it is reasonable to implement the interim maximum rates to protect consumers from excessive rates while the statistical plan data are obtained. The rates in 2000 are those which the companies themselves chose to use. The rate reduction allows for increased claims and expenses in the year of the reduction, so profit levels will not be substantially affected. While the rate reduction itself is uniform, it is applied to each company's rates, so the reduced rates themselves will not be uniform, but rather will be different, based on starting rates that are not identical between companies. Regulation by formula based on industry-average costs has long been practiced by regulatory agencies and approved by the courts. That includes applying numerical values adopted in regulations to individual companies' hearings without giving those companies the opportunity to adjudicate the values. See, e.g., *20th Century Ins. Co. v. Garamendi* (1994) 8 Cal.4th 216.

Summary (page 5): The Swiss Re paper is interesting. The CDI has not explained its reliance. There's been insufficient time to comment. I reserve my right to comment once I learn how the CDI has actually relied on the paper.

Response: The Swiss Re report was relied upon solely as an independent assessment of capital costs that is consistent with the Staff Report on Profit. Government Code section 11347.1 says that an agency must give the public at least 15 days prior to the date that the rulemaking action is adopted by the agency to review any study, report, etc.

Summary (page 5): A study of business practices in Washington has absolutely no relevance to California. The proposed remedy in Washington was not an arbitrary across-the-board rate reduction. If the CDI believes there are bad business practices in California, they should investigate and deal with them on a case-by-case basis. Such practices do not justify a wholesale revision of California's laws. Laws already exist to address such practices.

Response: The Washington study was relied upon as further evidence of anti-competitive practices in the title insurance industry. The Washington and California title markets are substantially similar. Similar practices are evident in California. The Washington study supports the commissioner's finding that a reasonable degree of competition does not exist.

<u>Summary of Comment (Bates pages Dec.Comments 606-615)</u>:
Bates pages Dec.Comments 606-615 are the comments of Gregory S. Vistnes dated December 15, 2006, submitted on behalf of Fidelity National Title Group.

Summary of Comment, Page 1: The commenter provides an introduction and summary of comments which are detailed in his submission.

Response: Responses to the comments summarized in the introduction and summary are provided below, so no response to the summary of comments is needed.

Summary of Comment, Page 2: The commenter argues that there is no evidence that historical rates of return are not "fair" and repeats his criticisms of the Birnbaum Report or cited any alternative studies or analyses that could be relied upon instead. The commenter states that the Birnbaum report does cite to other studies, but that these studies are not specific to California.

Response: The Commissioner rejects this comment. The basis for the commenter's claim that the Commissioner has no basis to conclude that historical rates of return are not indicative of a fair rate of return is his belief that the Birnbaum Report is flawed and no other studies are available. The Commissioner disagrees with the commenter and finds the Birnbaum Report persuasive that title insurers and underwritten title companies have earned excessive profits and that even the stated profitability understates the profitability of the title and escrow industry for several reasons. First, for many owners of underwritten title companies take profit as salary, bonus or commission, which reduces the stated profitability by turning profit into an expense. Second, there are many affiliate transactions among underwritten title companies, title insurance companies and other affiliates, some of which result in double-counting of expenses, some of which reflect profit reported as an expense, such as a management fee, and some of which are inflated expenses for services provided. Third, and most important, profitability, understood as the difference between revenue and the reasonable cost of providing a service is greatly understated because title insurers and underwritten title companies spend the bulk of what would otherwise be profit on expenditures that benefit the referrers of title and escrow business. This "profit" is spent on illegal kickbacks as well as legal expenditures that provide no benefit to the consumer paying for the product, but greatly benefit the real estate agents, mortgage brokers, lenders and homebuilders who are in the position to refer business to title insurance companies and underwritten title companies. The evidence of such expenditures is found in the captive reinsurance schemes under which title insurance companies rebated almost half of the title insurance premium to homebuilders and in the very large percentage of personnel costs devoted to sales, marketing and consumer support, where consumer support is the industry term used to describe free services to those entities considered "customers" by title insurance companies and underwritten title companies -- namely, real estate agents, mortgage brokers, lenders and homebuilders.

The commenter is incorrect when asserting that none of the studies cited in the Birnbaum Report are specific to California. The Peat Marwick study of 1980 examined title insurance and escrow pricing in California and found that escrow prices were far higher in Southern California than in Northern California, despite of or because of the presence of independent escrow companies – a situation that continues to exist 25 years later.

The remaining comments are repeated from an earlier submission. The Commissioner has responded to those comments and need not repeat the responses here.

Summary of Comment, Pages 3-5: The commenter argues that there is no basis to assume that sales expenditures are excessive. The commenter repeats his comments about principal agent relationships from his August 2006 submission.

Response: The Commissioner rejects this comment. The Commissioner has responded to those comments elsewhere in this file and need not repeat the responses here.

Summary of Comment, Pages 3-5. The commenter argues that the amount of money a firm spends on marketing will depend on how much influence those expenditures are likely to have on the decision maker and is not dictated by the level of competition in a market. The commenter cites a report of advertising expenditures by industry as evidence that sales expenditures and competition are unrelated. The commenter claims that the term reverse competition is misused when not describing a legitimate principal agent relationship but used to a situation where title insurers provide inappropriate incentives to real estate professionals to steer business to the title insurers. The author states that inappropriate incentives would like harm consumers, but such illegal conduct is not a consequence of reverse competition. Consumers are not harmed by reverse competition, but by illegal conduct. The commenter argues that the Commissioner has no basis to assume that there exists a phenomenon called reverse competition that reduces competition or that sales expenditures in markets characterized principal/agent relationships are excessive.

Response: The Commissioner rejects this comment. The report on marketing expenditures across industries is irrelevant to the question of whether a reasonable degree of competition exists in California title and escrow markets and whether the rates charged are reasonable for the product or services provided. The report is not useful given the many caveats presented in footnotes by the commenter. The Commissioner rejects the commenter's assertions about reverse competition, which are without any evidentiary support and contradicted by available facts. Reverse competition is a well-accepted concept in insurance economics and it is the commenter who is confused. Reverse competition specifically refers to a market structure in which sellers market to a third party in a position to deliver the business of the paying customer, as in title insurance and credit insurance markets. State legislatures and insurance regulators have long accepted the detrimental effects of reverse competition on consumers, including the pressure to increase prices by sellers to pay for the competition for referrals. The frequency of illegal rebates, as well as legalized forms of rebating such as affiliated business arrangements, in title insurance is much greater than found in other industries and, despite the commenter's claim to the contrary, is driven by the reverse competitive market structure of the title insurance market. There would be no reason for a title insurer to offer a kickback or engage in a captive reinsurance scheme unless there was market pressure to do so. The Birnbaum Report sets out ample evidence that reverse competition drives title insurers and underwritten title companies into activities that harm consumers by raising costs to the pay consumer without any commensurate benefit.

Summary of Comment, Pages 5-6: The commenter argues there is no basis to assume that sales expenditures should be based on some other reasonably competitive market as the Staff Report on the Sales Cost Factor does to justify the sales cost factor selection. The assumption that what is an appropriate level of sales expenditures in one market is appropriate for all markets is simply wrong. The range of advertising to sales varies dramatically by industry and within industries. The use of a comparable industry does not make the comparison of sales expenditures any more relevant. Moreover, there are differences between auto and title insurance that would cause differences in sales expenditures.

Response: The Commissioner rejects this comment. The commenter's analysis is flawed because it mismeasures sales and marketing costs. The sales cost factor specifically includes both personnel and non-personnel costs associated with sales and marketing, including so-called customer service. The commenter's analysis is based on non-personnel sales expenditures and is not a relevant comparison because the most significant aspect of excessive sales and marketing expenditures in title insurance are personnel costs. Further, the Staff Report on the Sales Cost Factor sets out a detailed explanation and basis for the selection of the sales cost factor and utilizes the most relevant sources of information – namely, the percentage of premium devoted to sales and marketing in lines of insurance not characterized by reverse competition. The commenter simply argues that there is no basis for anything the Commissioner is required to do and provides no alternative, let alone a reasonable alternative.

Summary of Comment, Pages 6-8: The commenter argues that there is no basis to assume that auto and homeowners markets are reasonably competitive, but offers no basis for such a categorization and has not conducted its own analysis of the market or commissioned a study. The speculates that auto and homeowners were selected as the comparison lines of insurance because they are unconcentrated industries and then criticizes the speculation by saying the concentration is not a reliable measure of competition and the Commissioner should not be determining whether a market is reasonably competitive based solely on concentration. The claim that auto and homeowners markets are competitive is in contrast to statements by the Commission that auto and homeowners insurers have achieved excessive profits in recent years. The commenter claims that auto and homeowners insurance markets are distorted by adverse selection and moral hazard.

Response: The Commissioner rejects this comment. The basis for the selection of the sales cost factor and the selection of other lines of insurance as reasonable benchmarks for sales and marketing expenses are detailed in the Staff Report on the Sales Cost Factor. Yet, instead of responding to the discussion in that report, the commenter invents reasons why the auto and homeowners lines of insurance were included and then attacks the reasons he has invented. The Commissioner finds the commenter's analysis completely unhelpful in evaluating either the proposed regulation or the various Staff Reports. While some regulators and consumer advocates have concerns about the degree of competition in auto and homeowners insurance markets, the majority of economists who analyze insurance markets believe that auto and homeowners insurance markets are competitive. Moreover, it is implausible that the commenter, who argues strenuously that title insurance markets are vigorously competitive, would reasonably argue that auto and homeowners insurance markets are not. As with his other arguments, the commenter simply states the Commissioner has no basis to take an action and offers no alternative, let alone a reasonable alternative.

Summary of Comment, Pages 8-9: The commenter argues that the Washington Office of the Insurance Commissioner Report on pervasive illegal kickbacks by title insurers in Washington indicates that regulators should stimulate competition and not eliminate it. The commenter notes that, instead of responding with rate regulation to replace competition, the Report calls for stimulating competition by increased enforcement of illegal rebate laws and increase education of consumers.

Response: The Commissioner rejects this comment. The commenter repeats his comments from earlier submissions that rate regulation is not desirable and harms consumers and again attempts to substitute his views for those of the California Legislature which has directed the Commissioner to regulate rates if a reasonable degree of competition does not exist in the business of title insurance and if the rates charged are not reasonable in relation to the insurance or services provided. Moreover, rate regulation is not incompatible with increased enforcement of illegal rebating laws and increased consumer education. The commenter sets up a false choice. Moreover, in the lengthy history of title insurance, there is no evidence that consumer education empowers residential consumers to a degree that they can discipline title insurers or escrow providers on price.

Summary of Comment, Pages 9-10: The commenter concludes by stating that that having made the decision to replace competition with rate regulation based in substantial part on a single discredited report (the Birnbaum Report), the Commissioner is now relying on incorrect and factually unsupported assumptions to formulate and support these rate regulations. The commenter concludes by repeating his objection to rate regulation.

Response: The Commissioner rejects this comment. The Commissioner disagrees that the Birnbaum Report is "discredited." All the criticisms of the Birnbaum Report have come from consultants hired by the title insurance industry with the task of critiquing the report. The Commissioner notes that no independent analyst has criticized the Birnbaum Report. The Commissioner has previously responded to the commenter's comments about the desirability of rate regulation and need not repeat those responses here.

Volume 10, Comment No. "Dec.comments 616":

Commentator: Norm McCracken
Date of Comment: November 30, 2006
Type of Comment: Written

Summary of Comment:
In the mail yesterday, I received a multi-page document from your office. I was puzzled as to why the Department would spend $4.20 in postage and whatever it cost to print and handle to send it. The address label bore my notary public commission number 1482541; otherwise, I would have been completely in the dark as to why it came to me and, I assume, all notaries public in California.

However, I am still at least partially in the dark as to its relevance to me as a notary public. I would appreciate a clarification.

Response to Comment:

Generally, this portion of the comment is not specifically directed at the Commissioner's proposed regulations or to the procedures followed in proposing the regulations. No response is, therefore, necessary. (Government Code Sections 11346.9 9 & 11346.8(c).)

The document was mailed to this individual because he submitted a comment on the original draft of the regulations. In accordance with California Code of Regulations section 44, the Department mailed a copy of the revised regulation text to the commenter.

Volume 10, Comment No. "Dec.comments 617-620":

Commentator: Old Republic Title Company/Rick Dosa
Date of Comment: Dated December 13, 2006, via facsimile
Type of Comment: Written

Summary of Comment (page 1):

This passage introduces Old Republic Title Company (ORTC) and distinguishes Old Republic National Title Insurance Company, which is their title underwriter.

Response to Comment:

This portion of the comment is not specifically directed at the Commissioner's proposed regulations or to the procedures followed in proposing the regulations, or simply summarizes comments which are summarized and responded to in more detail below. No response is, therefore, necessary. (Gov. Code section 11346.9.)

Summary of Comment (pages 1-2):

Under Insurance Code Section 12401, the Insurance Commissioner has no authority to establish the proposed rates and regulations. Section 12401 provides that ". . . nothing in this article is intended to give the commissioner power to fix and determine a rate level by classification or otherwise."

Response to Comment:

The Commissioner rejects this comment. The proposed regulations do not "fix" or "determine" rate levels. They define the level above which the rate is excessive. Companies are free to compete by charging any rate they wish so long as the rate is not "excessive." (Ins. Code § 12401.3.) It has long been understood that the code authorizes the Commissioner to prohibit excessive rates and that doing so does not constitute the proscribed fixing or determination of rates.

Summary of Comment (page 2):

The Insurance Commissioner is required and limited by Insurance Code Section 12401.3 to address and/or remedy any excessive, inadequate or unfairly discriminatory rates on an individual rate by rate, company by company, basis not on an industry-wide basis.

Response to Comment:

The Commissioner rejects this comment. No company's rate will be found to be excessive without a hearing. The regulations do not pertain to findings of inadequacy or unfair discrimination.

Summary of Comment (page 2):

The Commissioner's reliance on Proposition 103 is misplaced because Proposition 103, on its face, specifically excludes title insurance from its scope and application. Accordingly, the rate rollbacks effected for other lines of insurance are of no consequence or precedential value for the Commissioner's current attempt to set rates and rollbacks for the title industry.

Response to Comment:

The Commissioner rejects this comment. The Commissioner has not relied upon the provisions of Proposition 103 as authority for the proposed regulations. He relies on the applicable provisions of the Insurance Code, and not on Proposition 103, for the proposed regulations. To the extent the commenter is referring to the Commissioner's citation of Supreme Court cases arising under Proposition 103, in particular *20th Century Ins. Co. v. Garamendi* (1994) 8 Cal.4th 216, the Commissioner's reliance is limited to general constitutional and administrative-law principles governing rate-regulation and construction of common terminology (such as "excessive" and "inadequate").

The commenter fails to acknowledge that, with respect to the Commissioner's power to specify by formula a maximum rate, Proposition 103 (including specifically Ins. Code, § 1861.05) and the statutes governing title insurance (including specifically Ins. Code, § 12401.3) are not dissimilar. The text of Proposition 103 does not expressly authorize the Commissioner to determine whether a rate was excessive by formula – in fact, Proposition 103 does not even expressly authorize the Commissioner to adopt regulations to implement the measure. Yet the Supreme Court found the authority to adopt regulations, including specification of a formula to determine whether a rate is excessive, to be implied. (*20th Century Ins. Co. v. Garamendi* (1994) 8 Cal.4th 216.) The Commissioner certainly has the same power to implement the same statutory term, "excessive" – particularly since, unlike Proposition 103, Insurance Code section 12401.5 expressly authorizes the Commissioner to "prescribe by reasonable rules and regulations" a statistical plan, "for use in reviewing and evaluating individual rate filings" under Insurance Code section 12401.3.

Summary of Comment (pages 2- 3):

The Insurance Commissioner cannot enact Section 2358.8, entitled "Interest-Bearing Escrow Accounts" because the State of California is bound by the Order and Judgment in *State of California v. Old Republic Title*, San Francisco Superior Court Case No. 993507.

Section 2358.8(a) provides that where a party to an escrow timely elects to have funds it deposits placed in an interest-bearing account, a controlled escrow company may charge a fee for doing so, *which fee shall not exceed $25.00* (emphasis added in comment.)

Subsection (b) provides that where a controlled escrow company placed funds deposited with it in an account with an institution that provides the controlled escrow company with any benefits, *those benefits shall be fully and plainly disclosed to the depositing party, which shall be advised of its right to direct the deposit elsewhere and of the likely economic advantages of doing so.* (emphasis added in comment.)

In *State of California v. Old Republic Title* was sued under the Unfair Competition law for, amongst other things, failing to make certain disclosures to consumers who deposited funds into escrow accounts maintained and handled by ORTC.

On November 15, 2001, Judge Pollack granted ORTC's Motion for an Order Approving Interim Compliance Plan which permitted ORTC to charge consumers a fee of $45 to open and maintain an interest-bearing account, provided ORTC made the disclosures and followed the procedures specified in the compliance plan. That Order was subsequently incorporated into a Final Judgment which was affirmed on appeal.

ORTC submits that the proposed $25 fee is unreasonable and arbitrary and that the State of California and the Department of Insurance is bound by the Order and Judgment rendered in the action above as it relates to the rights of the title insurance industry as a whole and ORTC, to charge for and administer interest-bearing escrow accounts.

The Commissioner is estopped and precluded from enacting 2358.8 or otherwise from enacting rules concerning interest-bearing escrow accounts that are in conflict or inconsistent with the Judgment. The current action would appear to be void.

Response to Comment:

The Commissioner rejects this comment. The Commissioner was not party to the litigation to which the commenter refers and cannot be estopped from enforcing the law by the judgment.

Summary of Comment (page 4):

The recordkeeping and statistical plan requirements exceed the Commissioner's authority under Insurance Code Section 12401.5 with respect to setting reasonable rules and regulations for the annual reporting of financial data. The proposed requirements to account for and provide detailed information about title company personnel and the various roles and/or multi-tasks each renders, including time spent, to each party to a particular transaction is one example of the far-reaching and inappropriate application of the Proposed Rates and Regulations.

<u>Response to Comment</u>:

The Commissioner rejects this comment, for which the commenter has cited no authority. The Commissioner has found that the data required by the proposed regulations to be reasonably necessary to the purposes of Insurance Code section 12401.5.

<u>Summary of Comment (page 4)</u>:

The Proposed Rates and Regulations would impose an unreasonable and unnecessary economic impact on ORTC with no, or minimal, benefit to the CDI or consumers.

The proposed regulations provide for the creation of new recordkeeping requirements. ORTC believes no effort was exercised in assessing the financial impact and the efficacy of these provisions. ORTC has analyzed, to the extent possible, the projected time frames and economic impact for implementing the recordkeeping provisions. Based on ORTC's analysis, it would take 9-10 months for the initial implementation at an estimated cost of $300,000 to 400,000.

For all the above reasons, ORTC requests the Commissioner withdraw the Proposed Rates and Regulations.

<u>Response to Comment</u>:

The Commissioner rejects this comment. The reporting requirements have been found by the Commissioner to be reasonably necessary. The cost estimate, which the Commissioner does not necessarily credit, would not in any event militate against adoption of the regulations to prohibit excessive charges that appear to amount to hundreds of millions of dollars per year.

<u>Volume 10, Comment No. "Dec.comments 621-670</u>

Commentator: Old Republic National Title Insurance Company
Date of Comment: Dated December 14, 2006, received December 15, 2006
Type of Comment: Written

<u>Summary of Comment (page 1)</u>:

The first paragraph on page 1 is a preliminary statement.

<u>Response to Comment</u>:

This portion of the comment is not specifically directed at the Commissioner's proposed regulations or to the procedures followed in proposing the regulations, or simply summarizes comments which are summarized and responded to in more detail below. No response is, therefore, necessary. (Gov. Code section 11346.9.)

Summary of Comment (pages 1 - 2):

The comments on pages 1-2 are the same as those submitted to the Department during the 45-day comment period. In these comments, Old Republic contends it demonstrates that the Title marketplace works.

Response to Comment:

This comment does not regard the changes noticed on November 27, 2006, so no response is required. (Gov. Code section 11346.8(c).)

Summary of Comment (page 2):

The comments on page 2 are the same as those submitted to the Department during the 45-day comment period. In these comments, Old Republic contends that rates cannot be held excessive.

Response to Comment:

This comment does not regard the changes noticed on November 27, 2006, so no response is required. (Gov. Code section 11346.8(c).)

Summary of Comment (page 3):

Paragraph 1 of page 3 provides the same comments as those submitted to the Department during the 45-day comment period. In this portion of the comments, Old Republic contends that a study of title insurance rates show that title insurance rates have dropped and the Birnbaum Report does not consider the impact of expanded coverages, nor does it mention the special discount rates that have proliferated in recent years.

Response to Comment:

This comment does not regard the changes noticed on November 27, 2006, so no response is required. (Gov. Code section 11346.8(c).)

Summary of Comment (page 3) :

Paragraph 2 of page 3 provides the same comments as those submitted to the Department during the 45-day comment period. In this portion of the comments, Old Republic contends that the profitability rate for title insurers in 2004 "paled in comparison" to the return on equity for companies in the Dow Jones Industrial Average and the Standard & Poor's 500 that year and other service industries.

<u>Response to Comment</u>:

This comment does not regard the changes noticed on November 27, 2006, so no response is required. (Gov. Code section 11346.8(c).)

<u>Summary of Comment (page 3) </u>:

Paragraph 3 of page 3 provides the same comments as those submitted to the Department during the 45-day comment period. In this portion of the comments, Old Republic contends that while the Birnbaum Report acknowledges that there are forms of competition other than price competition, the Birnbaum Report proceeds to limit the consideration of competition for its analysis to price competition only, thereby failing to consider whether competition exists.

<u>Response to Comment</u>:

This comment does not regard the changes noticed on November 27, 2006, so no response is required. (Gov. Code section 11346.8(c).)

<u>Summary of Comment (page 3)</u>:

Paragraph 4 of page 3 provides the same comments as those submitted to the Department during the 45-day comment period. In this portion of the comments, Old Republic contends that the Birnbaum report conclusion that there is no rate competition is incorrect and that facts provided by Old Republic demonstrate that there is a broad range of rates to choose from.

<u>Response to Comment</u>:

This comment does not regard the changes noticed on November 27, 2006, so no response is required. (Gov. Code section 11346.8(c).)

<u>Summary of Comment (pages 3-4)</u>:
Paragraph 5 of page 3 provides the same comments as those submitted to the Department during the 45-day comment period. In this portion of the comments, Old Republic contends that the discussion of reverse competition and barriers to entry into the market place show that the Birnbaum Report conclusions are theoretical, rather than factual.

<u>Response to Comment</u>:

This comment does not regard the changes noticed on November 27, 2006, so no response is required. (Gov. Code section 11346.8(c).)

Summary of Comment (page 4):

The first full paragraph of page 4 provides the same comments as those submitted to the Department during the 45-day comment period. In this portion of the comments, Old Republic contends that, with regard to barrier to entry into the title insurance marketplace, the Birnbaum report fails to mention the scores of underwritten title companies and escrow companies that entered the marketplace in the past several years.

Response to Comment:

This comment does not regard the changes noticed on November 27, 2006, so no response is required. (Gov. Code section 11346.8(c).)

Summary of Comment (page 4):

Paragraph 2 of page 4 provides the same comments as those submitted to the Department during the 45-day comment period. In this portion of the comments, Old Republic contends that the proposed regulations seek to impose a maximum rate for title insurance and escrow services, in contravention of Insurance Code Section 12401, that the setting of a maximum rate only discourages price competition at a time when there is a great deal of variance in prices between insurers.

Response to Comment:

This comment does not regard the changes noticed on November 27, 2006, so no response is required. (Gov. Code section 11346.8(c).)

Summary of Comment (page 4):

Paragraph 3 of page 4 provides the same comments as those submitted to the Department during the 45-day comment period. In this portion of the comments, Old Republic contends that the Commissioner wishes to gather data pursuant to a statistical plan to analyze industry profitability and to adjust the maximum cost of title insurance in the future in contravention of Insurance Code Section 12401.5 and 12401.

Response to Comment:

This comment does not regard the changes noticed on November 27, 2006, so no response is required. (Gov. Code section 11346.8(c).)

Summary of Comment (page 4):

Paragraph 4 of page 4 provides the same comments as those submitted to the Department during the 45-day comment period. In this portion of the comments, Old Republic contends that collection of non-financial data exceeds statutory authority in contravention of Section 12401.5 which evinces a strong legislative intent that the information the

Commissioner may collect, pursuant to a statistical plan, relates only to financial performance.

<u>Response to Comment</u>:

This comment does not regard the changes noticed on November 27, 2006, so no response is required. (Gov. Code section 11346.8(c).)

<u>Summary of Comment (page 5)</u>:

Paragraph 1 of page 5 provides the same comments as those submitted to the Department during the 45-day comment period. In this portion of the comments, Old Republic contends that Proposition 103 is unavailing to the Commissioner as authority for the data submission regulations because: title insurance is excluded from its purview, there are several noteworthy differences between Proposition 103 (including the file and use system that applies to title insurers) and the statutes governing title insurance, and Section 12401.5.

<u>Response to Comment</u>:

This comment does not regard the changes noticed on November 27, 2006, so no response is required. (Gov. Code section 11346.8(c).)

<u>Summary of Comment (page 5)</u>:

Paragraph 2 of page 5 provides the same comments as those submitted to the Department during the 45-day comment period. In this portion of the comments, Old Republic contends that the proposed regulations' adverse economic impact was not adequately assessed.

<u>Response to Comment</u>:

This comment does not regard the changes noticed on November 27, 2006, so no response is required. (Gov. Code section 11346.8(c).)

Summary of Comment (Dec. Comments 627-670 Exhibits A and B):

These pages are – verbatim – the same comments submitted by this commenter for the originally-proposed draft regulations. (Compare bates pages "comments 1476-1518" with bates pages "Dec. comments 627-670")

Response to Comment:

This portion of the comment is not specifically directed at the revisions to the Commissioner's proposed regulations or to the procedures followed in proposing the regulations. No response is, therefore, necessary. (Government Code Sections 11346.9 & 11346.8(c).)

Volume 10, Comment No. "Dec.comments 671"

Commentator: Patty Le
Date of Comment: Dated and received December 1, 2006
Type of Comment: Written

Summary of Comment:

In response to our sending Ms. Le the Notice of Extension, she asked whether she should switch her home owner's insurance. She says that she does not have ADT, but does have a dog.

Response to Comment:

This portion of the comment is not specifically directed at the Commissioner's revisions to the proposed regulations or to the procedures followed in proposing the regulations. No response is, therefore, necessary. (Government Code Sections 11346.9 & 11346.8(c).)

Volume 10, Comment No. "Dec.comments 672-691":

Commentator: Patricia Laffin on behalf of Placer Title Company
Date of Comment: Received 12/13/06
Type of Comment: Written

Summary of Comment (page 1-2):

This passage identifies the commenter's affiliation. The commenter reserves her comments to issues relating to the revisions to the regulations, but notes that the commenter's objections to the originally-proposed regulations are equally applicable to the revised regulations.

Response to Comment:

This portion of the comment is not specifically directed at the Commissioner's proposed regulations or to the procedures followed in proposing the regulations. No response is, therefore, necessary. (Government Code Sections 11346.9 9 & 11346.8(c).) To the extent that the objections set forth in the commenter's remarks on the originally-proposed draft are incorporated by reference in the commenter's remarks on the revised regulations, the Commissioner incorporates his responses to those objections by reference.

Summary of Comment (page 2):

The Administrative Procedure Act requires the Department to respond to every comment submitted, concerning the regulations. Because Placer Title Company has not received a response to its originally-proposed comments, the commenter assumes that the revised regulations are meant to serve as the response. The commenter, therefore, concludes that the Department has rejected the concerns of Placer Title Company entirely.

Response to Comment:

The Commissioner rejects this comment. Contrary to the commenter's conclusion, the Commissioner did take the input of the public in the revised version of the regulations, including the commenter's comments on the originally-proposed regulations. Those revisions have led to a new calculation of the interim rate reductions for title and escrow, the right to apply for an exemption from the statistical plan reporting requirements, and an extension of time before the rates will take effect. Each of these changes, among others, was made in response to the comments of companies like Placer Title Company that expressed concern regarding the effect that the regulations would have on small companies.

The Administrative Procedure Act does not require an agency to submit a written response to each commenter. Instead, the Act anticipates that responses to comments will be set forth in the agency's rulemaking file and further acknowledges an agency's right to group comments together for a single response.

Summary of Comment (page 2):

The commenter's company has restricted its comments due to resource limitations. The commenter states that the company is unable to respond to the majority of revisions because of monetary constraints, lack of available expertise, and time limitations for the comments.

Response to Comment:

The Commissioner has provided the period for comment prescribed by statute. No response is otherwise required of this comment.

Summary of Comment (page 3-5):

The new geographic regions established for escrow in section 2358.9 of the revised regulations do not have a rational basis because the underlying presumptions concerning the rate of appreciation of housing in various parts of the state are flawed. The revised regulations base the interim rate reductions on home appreciation since 2000, but do not take into account the fact that not all areas of the state enjoyed the same rate of appreciation at the same time. For example, according to the Office of Federal Housing Enterprise Oversight (OFHEO), which tracks housing prices by region on a quarterly basis, the San Jose-Sunnyvale-Santa Clara region showed an increase of 21.32% in the first quarter of year 2000. During this same time period, Sacramento-Roseville showed an increase of 9.22%, Sacramento's increase was 5% and Redding's increase was 1.63%. Similarly, San Jose area prices decreased by 2.5% in the first quarter of 2002, while Sacramento and Redding's prices rose by 12.38% and 11.44% respectively.

The OFHEO also found that homes in the Bay Area had substantial appreciation prior to 2000, while the "Rest of State" experienced more appreciation after 2000. Thus, by applying a decrease of 7.4% to the Bay Area while applying a reduction of 23.6% to the "Rest of State", the regulations are grossly unfair.

Response to Comment:

The Commissioner rejects this comment. The amendments to the proposed regulations establishing regions were based on analysis of regional housing appreciation since 2000, which is the relevant period for regulatory provisions that specifically address appreciation since 2000, so the commenter's reference to pre-2000 appreciation is irrelevant. The analysis revealed a substantial difference between the Bay Area and the other two regions, which the Commissioner recognizes in the revised regulations. In fact, there is only a small difference between the Southern California and Rest of the State regions, however the Commissioner has chosen to recognize the two as separate regions, in part because of the unique escrow market in Southern California (i.e., the prevalence of independent escrow companies).

The commenter fails to show that variations within each region are large enough to be meaningful. (There is, for instance, no reason to attach significance to the difference of less than one percentage point in appreciation cited by the commenter between Sacramento and Redding.) The difference the commenter cites between San Jose and Sacramento-Redding confirms the propriety of the regional definitions, since San Jose is in Bay Area while Sacramento and Redding are in the Rest of the State, for which much larger interim-rate reductions apply.

Summary of Comment (page 5-6)

The geographic rate regions are arbitrary. For example, Sonoma County has been grouped with the Bay Area while Napa County is grouped with the "Rest of State" and would receive very different rate reductions under the revised regulations, despite the fact that the cost of housing in the two areas was quite similar, according to OFHEO.

Similarly, other counties with very different rates of appreciation have been placed in the same rate region. An example of this is Santa Cruz County, which in the first quarter of 1999 had a change in the housing price index of 11.26%, while Stanislaus County's change was 3.45%. Then, in 2000, the housing price index for Santa Cruz increased to 20.41%, while Stanislaus County only increased to 5.88%. After the first quarter of 2002, however, Santa Cruz slowed to 4.69% while Stanislaus County posted a 13.59%

gain. These two counties will be subjected to the same regional rate reduction, despite these differences.

Response to Comment

The Commissioner rejects this comment. Sonoma County, like the balance of the Bay Area region, had a significantly lower appreciation between 2000 and 2005 than Napa County and the Rest of the State. The balance of this comment appears to be based on the pre-2001 appreciation, which is irrelevant to the interim-rate reductions, which are intended to deal with the post-2000 housing increase.

Summary of Comment (page 6-7):

The new geographic regions established for escrow in section 2358.9 of the revised regulations is without a rational basis because the imposition of escrow rate regions fails to consider the realities of the Northern California business model for escrow because escrow rates in Northern California are not excessive, but rather, are currently inadequate. For example, First American Title Insurance Company's filed rate schedule shows an escrow fee of $2,000 for a $500,000 home in Los Angeles County, while the fee for the same escrow for the same home price in Sacramento would be $950. This disparity is due to the fact that escrow fees in Northern California are set to cover cost, with profits being derived primarily from the issuance of title insurance. This is not meant to imply that Southern California escrow rates are excessive, it is just meant to show that Northern California fees are already a bargain and cannot endure a 23.6% reduction.

Response to Comment:

The Commissioner rejects this comment. The commenter has failed to proffer any evidence to support the claim that existing, unregulated escrow rates are inadequate. The Commissioner notes that this comment appears to concede that the Northern California escrow rates are sufficient to cover costs and that it is the title rates that are excessive. The issue of cross-subsidies is irrelevant to the interim rates, which does not seek to correct the existing title versus escrow differentials. With respect to the post-interim, permanent rate regulations, the maxima will be determined by the results of the statistical plan, which will reveal the actual costs of title and escrow. Furthermore, the question of unfair discrimination lies beyond the scope of the proposed regulations; the commenter remains at liberty to file a complaint regarding with the Department and to seek an enforcement action against any unfair discrimination the commenter contends exists.

Summary of Comment (page 7-8):

The Commissioner has not explained why he thinks that escrow rates are excessive now, but were appropriate in 2000. Escrow rates are tied to sales price, and in the year 2000 the same $500,000 home would have resulted in a charge of $2000 in Los Angeles versus $950 in Northern California. It is unclear whether the Commissioner could conclude that

the rates charged by Northern California companies in 2000 were even adequate let alone excessive.
The commenter's escrow rates were not excessive in 2000 and are not excessive now. In fact, given current market conditions, the commenter's escrow rates are not even adequate to cover expenses.

Response to Comment:

The Commissioner rejects this comment. The Commissioner has never asserted that rates were appropriate in 2000. On the contrary, the Commissioner has been clear that because the lack of competition has been documented to exist in California for many years, it is very likely the 2000 rates were excessive, and the interim rates do not address that excess, which will be remedied only once the statistical plan makes it possible to prohibit excessive rates attributable to longstanding excesses. The commenter has proffered no evidence that 2000 rates were inadequate, a condition which companies could have remedied with rate filings if they felt that were the case.

Summary of Comment (page 8-9):

The Commissioner's regulations merely focus on some subsections of Insurance Code section 12401.3, while ignoring other subsections. For example, the Commissioner's regulations do not consider the provision which states that a rate is inadequate "if the continued use of the rate endangers the solvency of the person or entity using it." Out of all of the Staff Reports generated by the Department, not one of the reports looks into the question of whether the interim rates will lead to insolvency. Northern California escrow rates will be inadequate if the Commissioner does not fulfill his duty to the industry to make sure that rate changes caused by the interim reductions will not jeopardize a company's solvency. The Commissioner does not have the right to price "Rest of State" companies out of existence by requiring companies to decrease their rates by 23.6%.

Response to Comment:

The Commissioner rejects this comment. The Commissioner has been clear that the purpose of these regulations is to prevent the charging of excessive rates. To the extent inadequate rates are a problem, they can be dealt with on an ad hoc basis without need for regulations. That determination reflects the Commissioner's conclusion that there has been no showing that inadequate rates are nearly as widespread a problem (if inadequate rates exist at all) as is excessive rates.

Summary of Comment (page 10):

Section 2355.3, subsection (cc) now defines "title insurance company" to include title insurers, underwritten title companies and controlled escrow companies. The commenter was unable to find any limiting language that would make UTCs or controlled escrow companies "title insurance companies" for just certain purposes. Instead, the effect is to require UTCs and controlled escrow companies to comply with all of the obligations imposed on title insurance companies. For example, this would apparently include the requirement that UTCs must now provide the annual reports of title insurers. Given the irrational effects of this new definition, it is clearly erroneous.

Response to Comment:

The Commissioner rejects this comment. The definitions apply only to the balance of the regulations.

Summary of Comment (page 10-11):

Previous comments have noted a number of deficiencies in the proposed regulations, including the lack of a showing as to why 2000 is a good benchmark for profits, no indication that the Department has evaluated reduced price programs which came into existence after 2000, no evidence of an assessment of the amount by which illegal rebates inflate the cost of fees, and the lack of a study to show the effect of the current market on title industry profits. None of the new studies relied upon shed any light on these stated deficiencies, among others.

Response to Comment:

The Commissioner rejects this comment. The year 2000 is used as a "benchmark" only to define the period of sharp increase in title and escrow charges due to the sharp increase in housing costs. The underlying assumption, which the commenter has not proffered evidence to refute, is that the 2000 rates, which were chosen by the companies themselves without regulatory intercession, were satisfactorily profitable. The interim maxima merely preserve that profit level. Once the statistical plan has yielded the data necessary for the permanent regulatory provisions to take effect, no particular significance will be attached to 2000 rates.

Summary of Comment (page 11):

While the Department does not have the statutory authority to promulgate rates, even if it did, the new studies relied upon do not add measurably to the level of evidence the Department would need in order to promulgate rates.

Response to Comment:

The Commissioner rejects this comment. The proposed regulations do not constitute the promulgation of rates.

Summary of Comment (page 11-12):

The Washington State study does not speak to the conditions in California, and does not include information to address current market conditions or how much title premiums are inflated by illegal inducements. In fact, it appears that the Washington study concludes that rather than impose rate regulation on the industry, Washington will implement consumer education and enforcement as the appropriate tools to regulate the industry. The Commissioner would do well to follow the State of Washington's approach.

Response to Comment:

The Commissioner rejects this comment. The sole use to which the Washington report is put is to show that the problem of reverse competition appears to be widespread and the consequence of the nature of the title and escrow markets.

Summary of Comment (page 12-13):

The "2005 Title Insurance 5-years Profitability Report" contains a dizzying array of numbers but does not add much to the regulations. In fact, the study shows that some title insurance companies did not make money every year during the last five years. It also shows that some company's returns, such as Chicago Title Insurance Company were consistently low. Similarly, the range of annual profits in the tables ranges from a negative 204.77% to a profit of 121.59%, thereby demonstrating the significant variation among companies in the market. Rather than implement an individualized review of rates (which would have been permitted by the Insurance Code), the Commissioner's regulations require all companies to reduce their rates by the same amount despite significant differences among companies. This report does not justify the revised regulations.

Response to Comment:

The Commissioner rejects this comment. The purpose of the document was merely to provide aggregate information about industry-wide returns in the market without the proposed regulations. The fact that 22 companies licensed in California enjoyed average annual returns over five years ranging from 22.23% to 38.26%, numbers substantially higher than the Commissioner has found to be their cost of capital, provides substantial support for adoption of the proposed regulations.

Summary of Comment (page 13-14):

While the "Calculation of Profit Factor" Staff Report explains further the reasoning behind the Department's profit factor, it does not explain why property-casualty insurers represent an appropriate benchmark for title insurer costs of capital and rate of return. Property casualty insurers write premiums prospectively, charge for policies that generally are one year in duration, and in an environment which permits companies to adjust its return when its risk analysis is found to be overstated or understated. None of this is true for the title industry. Similarly, underwritten title companies cannot use an investment reserve of funds to contribute to their return, unlike property-casualty insurers.

Response to Comment:

The Commissioner rejects this comment. The staff report provides ample basis for selection of the property-casualty insurance industry as a basis for setting the authorized rate of return. The fact that property-casualty insurers write premiums prospectively implies that they are in a riskier business and are, if anything, entitled to a higher rate of return. While the longer "tail" of title insurance might be relevant were losses higher, the fact that title losses comprise only about 5% of premium, compared to a much more variable 70% or so for property-casualty insurers again militates in favor of, if anything, a lower profit level for title insurance. Whether UTCs enjoy the investment returns from reserves is irrelevant; those returns exist, and, if they are retained by the underwriter, that is, by statute, a matter for negotiation between the underwriter and the UTC.

Summary of Comment (page 14):

The Swiss Re Report is an analysis of the cost of capital in the property-casualty industry, which is free to analyze and reassess risk annually. Title insurers, by comparison, are not able to conduct the same reassessment.

Response to Comment:

The Commissioner rejects this comment. The property-casualty industry faces far higher losses, as a percentage of premium. Title losses rarely range far from 5%, so the title business is far less risky and, if anything, entitled to a lower rate of return.

Summary of Comment (page 14):

Although the Department has attempted to explain its reasoning with regard to the factors utilized in the rate methodology, the industry's comments remain unaddressed to a great extent.

Response to Comment:

The Commissioner rejects this comment. The Commissioner has addressed each comment from the industry in this file in response to the specific comment. No further response is necessary here.

Summary of Comment (page 15):

The Department was wise to move back its timeframe for data submission and the timeframe change is a welcome one. Given the amount of time it will take for companies to categorize and report the data, it is possible that some companies may be able to have systems in place to report the data under the new time frame, but it also begs the question: how many underwritten title companies will simply go out of business before that time?

Response to Comment:

To the extent this comment supports the amendments to the proposed regulations, no response is necessary. With respect to the balance of the comment, the commenter has proffered no evidence regarding the comment's rhetorical question, which appears irrelevant to the proposed regulations since it refers to the period before the cited portions of the proposed regulations would go into effect.

Summary of Comment (page 15):

While the Department has the authority to seek data from companies, it does not have the authority to set rates.

Response to Comment:

This comment is merely a restatement of the comments submitted on the earlier draft of the proposed regulations. The Commissioner incorporates his responses to those objections by reference.

Summary of Comment (page 15):

The reporting time frame in TI16 appears to have been inadvertently moved to 2207 under the regulations, rather than 2007.

Response to Comment:

The Commissioner agrees with this comment and has corrected the typographical error.

Summary of Comment (page 15-16):

It is puzzling to envision how the Department expects to be able to receive a massive data submission in April of 2007 and come out with a rational rate by October of 2007. Given that companies' data will not be consistently reported, this problem alone will likely take longer than from April to October, which means that the interim rates will come into effect.

Response to Comment:

The Commissioner rejects this comment. The Commissioner is entitled to assume that companies will comply with the proposed regulations in good faith. If they do, the detail and precision of the proposed regulations will minimize errors and make it possible to make the prescribed findings before it is necessary to implement interim rates.

Summary of Comment (page 16):

There is no basis for declaring the year 2000 an appropriate base year. There is also no finding that the interim rate reductions will have any relevance whatsoever to the market in 2007, given that the market has already changed significantly since the time the regulations were drafted. The Department would be well-advised to have some safety valve in lieu of a regulation that could decimate the title industry.

Response to Comment:

The Commissioner rejects this comment. The Commissioner has explained above the reason for selection of the 2000 base year. The commenter appears not to have noticed that the proposed regulations do have a safety valve for post-2006 market developments. (See §§ 2357.19(b), 2358.9(b).)

Summary of Comment (page 16-17):

While the Department has the authority to promulgate a data call, Insurance Code section 12401.5 requires the data call to be reasonable and reasonably adapted to the rating systems in use within the state. The regulations are unreasonable because they seek to impose an entirely new and unique accounting, timekeeping, recordkeeping and report writing system on companies. The costs of attempting to comply with this regulation will drive some companies out of the market prior to their first data submission.

Response to Comment:

This comment is merely a restatement of the comments submitted on the earlier draft of the proposed regulations. The Commissioner incorporates his responses to those objections by reference.

Summary of Comment (page 17):

The revised regulations do not address the prohibitive cost of the new systems that will be required by the regulations, which will cost mid-to-large title companies millions of dollars to implement. Additionally, new staff will be required and the companies will need to meet routinely with the Department to understand the data fields. The regulations do nothing to address the fact that it will take years for the data submissions by companies to become consistent and coherent. This will reduce competition and result in increased costs to title insurance companies and consequently to consumers.

Response to Comment:

This comment is merely a restatement of the comments submitted on the earlier draft of the proposed regulations. The Commissioner incorporates his responses to those objections by reference.

Summary of Comment (page 17-18):

While the commenter has not examined every data field page by page, it is clear that the Department has not addressed many problems. For instance, the revised regulations do not address the complexity of the data call and the fact that it will be impossible to categorize the expenses and costs under the Department's proposed methodology. Moreover, overnight courier charges are to be allocated between title and escrow. This will either cause the companies to send two separate packages or increase the amount of time that employees must expend to count pages and allocate the costs between title and escrow. Detailed logs of phone calls, conversations and notes made for title business versus escrow business will be necessary to account for the division of labor between title and escrow activities. Similarly, the date field "Other Services Not Provided" is unfathomable.

Response to Comment:

This comment is merely a restatement of the comments submitted on the earlier draft of the proposed regulations. The Commissioner incorporates his responses to those objections by reference.

Summary of Comment (page 18):

Many smaller underwritten title companies will elect to shut their doors or sell out to larger title companies rather than face the burdens of excessive cost and detailed reporting as required by the revised regulations. The commenter is not certain that its mid-sized company will be able to weather these changes.

Response to Comment:

The Commissioner rejects this comment. The proposed regulations have been amended to provide an exemption to smaller independent UTCs until software or services become commercially available. The commenter has proffered no evidence that larger companies will not be able to comply with the amended proposed regulations.

Summary of Comment (page 19):

The revised regulations appear to represent the most expensive, complex and time consuming method possible. The regulations will increase the cost of title insurance for consumers. Perhaps the Department is motivated, in part, by the desire to replace the cost of illegal inducements and kickbacks with the cost of a new staff and division of public employees to administer these new regulations. The regulations will not benefit consumers, however and are not reasonable.

Response to Comment:

The Commissioner rejects this comment. They commenter has not proffered evidence that there exist less expensive, complex, or time-consuming means that would be effective in preventing excessive rates.

Summary of Comment (page 19-20):

The Legislature authorized the Commissioner to review individual rates filed by individual companies – not to set rates. The Legislature also required the Commissioner to develop reasonable data reporting rules. By attempting to set rates by terming such rates "maximum" rates, and requiring such burdensome data reporting, the Commissioner's regulations are in contravention of the Legislature's dictates. The revisions to the regulations merely delay, but do not remedy, the inevitable destruction of the business of underwritten title companies.

Response to Comment:

The Commissioner rejects this comment. The proposed regulations provide for company-specific findings with regard to excessive rates, informed, as those findings properly should be, by the proposed regulations. The proposed regulations do not set rates, they merely define the level at which rates become excessive. Companies remain free to charge any lawful rate that is not excessive. The commenter has failed to proffer any evidence to support the claim that the regulations will destroy the business of UTCs that are sufficiently efficient to operate in a competitive market.

Volume 10, Comment No. "Dec.comments 692"

Commentator: Susan Nichol
Date of Comment: November 30 2006
Type of Comment: Written

Summary of Comment:

The commentator is requesting a sample complaint that she can sign and send in.

Response to Comment:

This portion of the comment is not specifically directed at the Commissioner's proposed regulations or to the procedures followed in proposing the regulations. No response is, therefore, necessary. (Government Code Sections 11346.9 9 & 11346.8(c).)

Volume 10, Comment No. "Dec.comments 693-705"

Commentator: Roger McNitt, on behalf of United General Title Company
Date of Comment: 12/15/06
Type of Comment: Written

Summary of Comment (page 1):

This passage summarizes the commenter's affiliation and summarizes the revisions to the proposed regulations.

Response to Comment:

This portion of the comment is not specifically directed at the Commissioner's proposed regulations or to the procedures followed in proposing the regulations. No response is, therefore, necessary. (Government Code Sections 11346.9 9 & 11346.8(c).)

Summary of Comment (page 1-2 and Exhibit A):

The revisions to the proposed regulations fail to correct a major flaw. The revised regulations still reflect the Commissioner's intent to create a prior approval system for title insurance and escrow rates, like the prior approval system for property and casualty rates embodied in Proposition 103. Exhibit A provides a comparison of each of the amended proposed factors and the Proposition 103 prior approval components that are similar to those revisions. As the commenter indicated in his comments on the original draft of the regulations, the Commissioner does not have the authority to impose a prior approval system of regulation for title insurance rates.

Response to Comment:

This comment does not regard the changes noticed on November 27, 2006, so no response is required. (Gov. Code section 11346.8(c).)

Summary of Comment (page 2 and Exhibit B):

The Commissioner cites to *20th Century Insurance Co. v. Garamendi* (1988) 8 Cal.4th 216 as authority for the proposed regulations, and this authority citation is misplaced. The *20th Century* case, and its recognition of the Commissioner's authority to impose a prior approval system of regulation over property and casualty insurers, does not extend to title insurance. Exhibit B to these comments, which is a letter to Senator Zenovich concerning the relevant title insurance bill, demonstrates that the title insurance code sections (Ins. Code section 12401 *et seq*.) were intended to create a McBride-Grunsky pattern of rate regulation – not a prior approval system.

Response to Comment:

This comment does not regard the changes noticed on November 27, 2006, so no response is required. (Gov. Code section 11346.8(c).)

Summary of Comment (page 2):

The Commissioner cites to *20th Century Insurance Co. v. Garamendi* (1988) 8 Cal.4th 216 as authority for the proposed regulations, and this authority citation is misplaced. The *20th Century* case noted in footnote 15 at page 287 that Proposition 103 repealed the prohibition against the Commissioner's power to fix and determine rates for property and casualty insurance. This prohibition still exists for title insurance, however.

Response to Comment:

This comment does not regard the changes noticed on November 27, 2006, so no response is required. (Gov. Code section 11346.8(c).)

Summary of Comment (page 2-3 and Exhibit C):

As is reflected in Exhibit C, the Department's website notes that "prior to Prop. 103, California Department of Insurance … operated under McBride-Grunsky Insurance Regulatory Act. This Act did not require insurance companies to file rates for approval except for health and life." The Department's website also lists the lines of insurance that Proposition 103 applies to. Notably absent from this list is title insurance. Thus, as the Department's own website makes clear, Proposition 103 is not applicable to title insurance rates. The Commissioner, therefore, lacks authority to adopt the revised regulations because they are inconsistent with the relevant statutes.

Response to Comment:

This comment does not regard the changes noticed on November 27, 2006, so no response is required. (Gov. Code section 11346.8(c).)

Volume 10, Comment No. "Dec.comments 706-709"

Commentator: Patricia Bower, on behalf of Westcor Land Title Insurance Company
Date of Comment: 12/15/06
Type of Comment: Written

Summary of Comment (coverpages on bates page 706-707):

These are cover pages to the comments.

Response to Comment:

This portion of the comment is not specifically directed at the Commissioner's proposed regulations or to the procedures followed in proposing the regulations. No response is, therefore, necessary. (Government Code Sections 11346.9 9 & 11346.8(c).)

Summary of Comment (page 1):

This passage summarizes the commenter's affiliation. The commenter also states that the commenter's objections to the originally-proposed regulations are incorporated by reference and also supports the comments filed by Placer Title and the CLTA.

Response to Comment:

This portion of the comment is not specifically directed at the Commissioner's proposed regulations or to the procedures followed in proposing the regulations. Additionally, this portion of the comment reflects summaries of comments that are summarized and responded to in greater detail below. No response is, therefore, necessary. (Government Code Sections 11346.9 9 & 11346.8(c).) To the extent that the objections set forth in the commenter's remarks on the originally-proposed draft are incorporated by reference in the commenter's remarks on the revised regulations, the Commissioner incorporates his responses to those objections by reference. The comments of Placer Title and CLTA have been summarized and responded to separately.

Summary of Comment (page 1-2):

The commenter objects to the Department's decision to add new documents and reports to the rulemaking file as part of the November 27 Notice of Availability of Changed Text, in part, because those documents were not cited in the initial statement of reasons supporting the regulations.

In particular, the commenter objects to the "2005 Title Insurance 5-years Profitability Report." The data is used to illustrate the return on equity over the past five years for all underwriters. The data on other underwriters is irrelevant to the commenter's company, which was not profitable every year during the five years studied. The report should not be used to apply uniform regulations, because of the extent to which profitability margins varied greatly among different underwriters. Some underwriters, like the commenter's company, retain less than 10% of the premium in some cases, while larger underwriters with direct operations may retain as much as 100% of the premium. The proposed regulations represent a "one-size-fits-all" approach that is not fair and is beyond the Commissioner's authority.

Response to Comment:

The Commissioner rejects this comment. To the extent that the Commissioner has placed additional documents in the file, they are either documents that were not previously available or documents that respond to comments from the public regarding the original proposal. Members of the public have been given a full opportunity to comment on those reports. The procedure fully complies with the applicable statutes.
Regulation by formula based on industry-average costs has long been practiced by regulatory agencies and approved by the courts. That includes applying numerical values adopted in regulations to individual companies' hearings without giving those companies the opportunity to adjudicate the values. (See, e.g., *20th Century Ins. Co. v. Garamendi* (1994) 8 Cal.4th 216.)

Summary of Comment (page 2):

The commenter's company is unique in that it does not have direct operations in California and does not market to the real estate industry. The company derives its income solely from underwritten title companies in California. Moreover, the commenter's company does not engage in rebating activities and should not be penalized for the wrongdoing of other companies. The proposed regulations will put the underwritten title companies out of business and will have a devastating impact on regional underwriters like the commenter's company, which provide an invaluable alternative to the real estate industry and consumers.

Response to Comment:

The Commissioner rejects this comment for the reasons stated in the preceding response. The commenter has proffered no evidence to support the dire predictions regarding driving companies out of business.

Summary of Comment (page 2):

Because the proposed regulations will eliminate the smaller independent companies, rather than encourage competition, the regulations will have the opposite effect.

Response to Comment:

The Commissioner rejects this comment. The commenter has not demonstrated that smaller independent companies will be driven out of business. In general, the proposed regulations will ensure that prices will not exceed the levels that would obtain in a competitive market, which the Commissioner has found not to exist. Under a competitive market, less efficient companies will sometimes exit the market, but the commenter has not shown that smaller independent companies will necessarily be less efficient, nor that they cannot succeed without charging excessive rates.